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The Antitrust of Reputation Mechanisms: Institutional Economics and Concerted Refusals to Deal

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ABSTRACT

An agreement among competitors to refuse to deal with another party is traditionally per se illegal under the antitrust laws. But coordinated refusals to deal are often necessary to punish wrongdoers, and thus to deter undesirable behavior, that state-sponsored courts cannot reach. When viewed as a mechanism to govern transactions and induce socially desirable cooperative behavior, coordinated refusals to deal can sustain valuable reputation mechanisms. This paper employs institutional economics to understand the role of coordinated refusals to deal in merchant circles and to evaluate the economic desirability of permitting such coordinated actions among competitors. It concludes that if the objective of antitrust law is to promote economic welfare, then per se treatment – or any heightened presumption of illegality – of reputation mechanisms with coordinated punishments is misplaced.

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**THE ANTITRUST OF REPUTATION MECHANISMS:
INSTITUTIONAL ECONOMICS AND
CONCERTED REFUSALS TO DEAL**

Barak D. Richman

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In business a reputation for keeping absolutely to the letter and spirit of an agreement, even when it is unfavorable, is the most precious of assets, although it is not entered in the balance sheet.

-Lord Chandos (Oliver Lyttelton)¹

I. INTRODUCTION

Though certainly not the first to remark on the value of a good reputation,² Oliver Lyttelton nicely observes how reputations are often called upon to fill the gaps of agreements that are beyond the reach of courts. Prior scholarship has observed that reputations can serve to monitor product quality,³ reduce litigation costs,⁴ and – the focus of this paper – enforce executory contracts.⁵ In all of these instances, institutions support reputation mechanisms to enforce pledges that are either unenforceable or too costly to enforce in court.

¹ OLIVER LYTTTELTON CHANDOS, *MEMOIRS OF LORD CHANDOS: AN UNEXPECTED VIEW FROM THE SUMMIT* (New American Library 1963).

² See, e.g., Publilius Syrus, 1st Century B.C. (“A good reputation is more valuable than money.”). Given the combination of economic and noneconomic sanctions discussed *infra*, and given the devastating completeness of these sanctions, perhaps Casio put it best after Othello dismissed him following Casio’s participation in a drunken brawl: “*Reputation, reputation, reputation! O, I have lost my reputation! I have lost the immortal part of myself, and what remains is bestial.*” WILLIAM SHAKESPEARE, *OTHELLO*, act 2, sc. 3.

³ See Benjamin Klein & Keith Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

⁴ See Ronald Gilson and Robert Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509 (1994).

⁵ See Barak Richman, *How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York*, 31 LAW & SOC. INQUIRY 383 (2006); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 11 J. LEGAL STUD. 115 (1992).

Could it be, then, that reputation mechanisms amount to an antitrust violation? This article says that, yes, they could, but that, generally, they should not. They could because (among other reasons) reputation mechanisms foreclose commerce to targeted individuals and amount to a group boycott, which the Supreme Court as recently as 1998 reiterated is a *per se* violation of US antitrust law.⁶ They should not, however, because many reputation mechanisms arise to govern desirable economic activity and are comparatively efficient to public courts, firms, and other enforcement instruments that antitrust does not scrutinize. To the degree that these reputation mechanisms might run afoul of current antitrust law, and to the degree that antitrust law strives to maximize economic welfare,⁷ reputation mechanisms identify useful and needed reforms to current antitrust law.⁸

⁶ See *NYNEX v. Discon, Inc.*, 525 U.S. 128 (1998) (“The Court has found the *per se* rule applicable in certain group boycott cases ... involving horizontal agreements among direct competitors.”). See also *infra*, note 32, listing cases. See Part II for alternative paths in which reputation mechanisms can conflict with U.S. antitrust law.

⁷ *NCAA v. Bd. of Regents*, 468 U.S. at 107 (“Congress designed the Sherman Act as a consumer welfare prescription”); ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 91 (1978) (“The whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.”). There is a debate in antitrust law over the objective is to maximize consumer welfare or total welfare. Compare *FTC v. University Health, Inc.* 938 F.2d 1206, 1222-23 (11th Cir. 1991) (advocating a consumer welfare standard) and *United States v. United Tote, Inc.*, 768 F. Supp. 1064, 1084-85 (D. Del. 1991) (same) with Oliver E. Williamson *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 1372 (1968). Judge Bork, in fact, advocated for a total welfare standard, noting that “consumer welfare ... is merely another term for the wealth of the nation. Antitrust thus ... has nothing to say about the way prosperity is distributed or used.” BORK, *THE ANTITRUST PARADOX*, 90.

For a survey and assessment of economic arguments in favor of applying a consumer welfare standard in antitrust analysis, see Joseph Farrell & Michael L. Katz, *The Economics of Welfare Standards in Antitrust*, 2 COMPETITION POL’Y INT’L 3 (2006).

⁸ Loosening the antitrust laws in this fashion, and narrowing the application of the *per se* rule, is consistent with recent Supreme Court rulings. See, e.g., *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. ____ (2007). It also is consistent with Frank Easterbrook’s prescient remark more than two decades ago, “As time goes by, fewer and fewer things seem appropriate for *per se* condemnation.” *The Limits of Antitrust*, 63 Texas L. Rev. 1, 10 (1984).

Since much of antitrust analysis rests on intensive factual determinations, this article examines the intersection of antitrust and reputation mechanisms by focusing on a specific case study: the use of reputations among New York’s diamond merchants. The diamond industry might be considered a paradigmatic illustration of reputation mechanisms and associated group boycotts since the industry governs its contracts solely – without any aid of court enforcement – with reputations and coordinated punishment. Though few industries are comparable, it has been noted that “the study of extreme instances often helps to illuminate the essentials of a situation.”⁹ Examining the diamond industry is fruitful not because it is a representative industry, but because it crisply reveals the underlying tension between private ordering and competition law like few illustrations can.

Part I offers the factual background. It details how the diamond industry implements a reputation mechanism to enforce executory contracts and sustain reliable transactions on credit without relying on state-sponsored courts. Part II then presents the potential legal challenges, illustrating the variety of ways in which the diamond industry’s use of reputations might violate U.S. antitrust law. Part III contains the justification for reforming antitrust law. It employs transaction cost economics to illustrate that reputation mechanisms and their corresponding group boycotts can be institutionally efficient mechanisms to enforce diamond transactions. The diamond industry’s reputation mechanism is a horizontal restraint designed to compensate for the deficiencies of state courts, and thus it should be construed under antitrust law as a procompetitive joint venture rather than a *per se* (or any other kind of) violation of the Sherman Act. This comparative institutional analysis reveals that while reputation mechanisms do pose hazards, and thus appropriately encounter scrutiny from antitrust law, transaction cost

⁹ Behavioral Sciences Subpanel, President’s Science Advisory Committee (1962) ‘Strengthening the Behavioral Sciences’ 136 *Science* 233, discussed in OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (1985), at 35 (“Inasmuch as the study of extreme instances often helps to illuminate the essentials of a situation (Behavioral Sciences Subpanel, 1962, p. 5), an examination of the problems faced by a company town may instructive.”)

economics can guide an antitrust rule of reason analysis that indicates when reputation mechanisms should be permissible. Part IV then discusses the very few antitrust suits that have been filed against the U.S. diamond industry's trade association, the New York Diamond Dealers' Club. It observes that even though these suits introduced antitrust enforcers to the use of group boycotts among the New York's diamond dealers, none of those suits demanded a structural change to the industry's private enforcement. Though the enforcement history offers murky lessons, it suggests that antitrust policymakers have been hesitant to disturb the industry's system of self-policing and perhaps have recognized the efficiencies of the industry's use of group boycotts.

I. THE SETTING: PRIVATE ORDERING OF DIAMOND TRANSACTIONS¹⁰

The underlying mechanics of a reputation mechanism are well-understood. Individuals base their decisions to enter into relationships with others on the past actions of their potential partners. In the commercial context, merchants will enter into contracts only with individuals who have adequately fulfilled the obligations imposed in their previous contracts, thus avoiding (or perhaps demanding a premium from) all individuals who have acted badly in the past. In equilibrium, the prospect of losing future business opportunities (or paying future premiums) is sufficient to deter bad behavior, thus the reputation mechanism – and the credible threat of coordinated punishment of individuals who earn bad reputations – is sufficient to induce contractual compliance and support reliable exchange.

However well understood the theory is, the practicalities of implementing a reputation mechanism are daunting. The central challenges include (1) facilitating the prompt dissemination of accurate information so a merchant's past acts are known to all potential exchange partners, and (2) coordinating a credible and sufficiently painful punishment that deters misconduct. For the diamond industry, the primary governance task – and

¹⁰ Much of this section is adapted from Richman, *supra* note 5.

the purpose for which reputation mechanisms are relied upon – is enforcing the credit sale. Since diamonds are portable, virtually untraceable, and universally valuable, credit sales – in which a buyer pays for diamonds subsequent to their delivery – introduce an enormous risk of flight.¹¹ The diamond industry’s reputation mechanism, by credibly promising that the benefits of compliance outweigh the benefits of cheating or flight, remarkably overcomes the hazards of flight and theft.

The Industry’s Rules

The diamond industry’s central nervous system – the mechanisms which enable the industry’s use of reputations and support exchange – lies in its network of diamond bourses scattered throughout the world’s diamond centers. New York’s bourse, the New York Diamond Dealers’ Club (DDC) located in Manhattan’s diamond district on 47th Street, is organized like the others as a voluntary association with by-laws and mandatory rules for its diamond merchant members. The DDC’s approximately 1,800 members organize the vast majority of America’s commercial traffic in diamonds, with most members being middlemen between the diamond producers who mine the stones (most of which are organized by the DeBeers syndicate) and the diamond retailers who purchase the stones and convert them into jewelry. Nearly half of the world’s \$60 billion sales in diamond jewelry are in the United States¹², and DDC members handle over 95% of the diamonds imported into the US.¹³

¹¹ Diamonds remain the choice currency of fleeing fugitives. *See, e.g.*, ELLEN JOAN POLLACK, *THE PRETENDER* (2002) (recounting the story of Martin Frankel, the troubled fugitive financier whose collapsed financial schemes prompted federal prosecution, and his attempted escape from U.S. authorities, in which he arranged a shadowy purchase of several million dollars of diamonds hours before his flight from the United States). Courts offer few, if any, reliable mechanisms – whether enforcement efforts through contracts, liens, or otherwise – to prevent an individual from stealing diamonds that he is obligated to pay for.

¹² *See* Jason Feifer, *Diamonds Shine On*, TELEGRAM & GAZETTE, April 1, 2004 (international figures); Susan Thea Posnock, *Journey helps diamond jewelry rise 6.1 percent in '06*, NAT’L JEWELER, May 2007, at 4 (U.S. figures).

¹³ *See* Thomas J. Lueck, *Diamond District Tries to Dispel Its Private Bazaar Image*, NEW YORK TIMES, December 12, 1997, at B1.

Since most diamonds are bought and sold several times before they are purchased ultimately by a jewelry manufacturer, DDC merchants are active traders and transact with each other frequently.

As a voluntary association, the DDC has extensive rules and by-laws to which each member must agree upon admission to the DDC, and failure to comply with DDC rules would lead to a member's dismissal. The DDC rules govern much of the members' commercial activity, including the mechanics of executing diamonds sales between DDC merchants (for example, DDC by-laws assert that all oral agreements are binding when certain words are used to express accord, that written offers made through brokers are open until 1pm of the following day, and that DDC-provided scales will determine the official weight of transacted diamonds).¹⁴ DDC by-laws also establish rules for transactions with out-of-town dealers, the requirements of maintaining membership in good-standing, and the rigorous process of admitting new members.¹⁵

The most important element of the DDC by-laws is the provision of an arbitration panel.¹⁶ Arbitrators are fellow DDC members who have earned the respect of their peers and have abundant industry expertise. The panel abides by its own set of procedures that limit testimony (and thus a trial's length) and enable arbitrators to ask questions and probe into fact-finding. These rules enable arbitration panels to arrive at prompt and informed rulings.¹⁷ More significantly, the by-laws require that any dispute that might arise between DDC merchants – whether a seller accuses a buyer of missing payment, or whether a buyer accuses a seller of failing to furnish the diamonds that were promised – must only be brought before the DDC's Arbitration Panel. Members are prohibited from suing each other in New York state courts or any other system of dispute resolution.

¹⁴ See DDC by-laws, Article XVIII (“Trade Rules”).

¹⁵ See *id.* at Articles III (“Members”), XVII (“Out-Of-Town Dealers”).

¹⁶ See *id.* at Article XII (“Arbitration”).

¹⁷ Bernstein, *supra* note 5, describes at length the many efficiency-enhancing features of the DDC's adjudication process. See *id.* at 135–38, 148–51.

The arbitration panel is at the fountainhead of the industry's reputation mechanism. Once a panel has reached a conclusion, it announces nothing more than its judgment, which amounts to identifying the merchant against whom the panel issued a judgment, the date the judgment was decided, and the amount owed. The individual found to be liable has an opportunity to pay his debt to the merchant who brought the suit, and if he does so he remains a DDC member in good standing. However, if that individual fails to make payment immediately following the arbitration panel's decision, he is dismissed as a member of the DDC. In addition, a picture of the individual in default is placed on the wall of the DDC's central trading hall with a caption that details his failure to comply with the arbitration panel's ruling, and the default is immediately made known to all DDC members. News of the individual's default spreads rapidly throughout the global marketplace, as similar pictures and captions are placed in the world's twenty-two other diamond bourses as well. This formal dissemination of information supplements the transmission of news through the many informal information networks, that find their home in the DDC and world's other bourses. Each bourse, which house restaurants, prayer halls, and other areas where members congregate regularly, are designed to gather merchants together and thus collect and disseminate valuable market and reputation information.¹⁸

Thus, the DDC's procedures – and the similar procedures of the world's other diamond bourses – ensure that news of an individual's default spreads quickly to all future potential trade partners. Such news substantially affects commercial opportunities. Merchants in default have tremendous difficulty obtaining further business, and maintaining a DDC membership in good standing becomes a signal to other merchants of a spotless past. Even though former DDC members are prohibited from entering the DC trading halls, nothing legally precludes them from remaining in the diamond business, and more important, no law and nothing in the DDC by-laws precludes other diamond merchants from dealing with individuals who were expelled from the DDC. The DDC by-laws require nothing more than the expulsion a member in default and the posting of his

¹⁸ See Richman, *supra* note 5; Bernstein, *supra* note 5 (1992).

picture and his arbitration-determined debt on the DDC's wall. Nonetheless, current DDC members will rarely transact with merchants who were dismissed from the DDC, regardless of how attractive a deal the dismissed member offer, because their own reputations would be sullied by dealing with members who have failed to live up to previous commitments. In short, merchants dismissed from the DDC are generally shut out of the lucrative diamond business.

How It Works

Rudimentary game theory suggests that the threat of coordinated punishment will deter misconduct only if the benefits of long-term cooperation exceed the value of a one-time defection. For the typical diamond transaction, the value of a one-time defection – stealing a cache of diamonds – is enormous. In order to settle upon an equilibrium of long-term cooperation and contractual compliance, the diamond industry rests on a remarkable network of family and community institutions.¹⁹ Merchants almost exclusively come from family businesses and thus are eager to secure the long-term value of reputations, including the value of bequeathing a good reputation – and thus a lucrative business – to one's heirs.²⁰ And merchants also almost exclusively come out of tightly-knit, ethnically homogeneous communities (DDC members, for example, come predominantly from ultra-orthodox Jewish communities), so community institutions both disperse and withhold club goods, respectively, to cooperating and defecting merchants.²¹ For example, synagogues and other community religious institutions bestow honors and allocate scarce services to respected members while withholding them from community members in lower repute, thus, a merchant's business reputation shapes his reputation

¹⁹ These family and community institutions not only explain how diamond merchants manage to sustain cooperation, but they also explain why the industry is dominated by ethnic networks. In short, these institutions provide merchants from certain ethnically homogeneous and insular groups a comparative advantage over other potential competitors. See Richman, *supra* note 5,

²⁰ See *id.* at 403-04.

²¹ See *id.* at 407-08.

in, and enjoyment from, his religious community.²² These family and community mechanisms secure long-term cooperation and credibly enforce credit sales *despite* the tremendous value of cheating a diamond seller.

These private ordering mechanisms highlight how arbitration rulings from the diamond industry differ from other arbitration rulings. In most commercial arbitration rulings, the victorious party proceeds to a state-sponsored court to enforce the arbitration ruling against an in-compliant party, and according to the Federal Arbitration Act²³ (and similar statutes in other countries), public courts defer to the arbitrators' ruling and proceed to use their available mechanisms – such as seizures of assets, or the use of Marshalls and state-sanctioned coercion – to enforce the arbitration judgment. Public courts, however, are completely toothless to enforce a diamond credit sale. Though traditional mechanisms such as seizure or liens work effectively for less portable and more identifiable assets, state courts are ineffective in locating or securing a cache of disputed diamonds and transfer them to their rightful owner. It is for this reason that diamond transactions – and DDC arbitration awards – are enforced exclusively through reputation mechanisms.

The reliance on reputation mechanisms also means that the reach of the DDC arbitration board is limited to cooperating parties. Merchants comply with the DDC arbitration board only to preserve good reputations and protect the opportunity to engage in future diamond transactions. Accordingly, the role of the DDC's arbitration board is purely informational, and the power of its dispute resolution system rests on the degree to which it can provide merchants with the required information to support a reputation mechanism that forecloses future transactions to uncooperative merchants.²⁴

²² *Id.*

²³ Federal Arbitration Act of July 30, 1947, ch. 392, § 1, 61 Stat. 669 (codified as amended at 9 U.S.C. § 1-14 (2000)).

²⁴ Milgrom, North, and Weingast similarly characterize the role of private judges in supporting trade between 16th century Law Merchants in the Champagne Fairs. The judges' power did not arise from an inherent power to enforce agreements but rather from the ability to disseminate information and support a reputation mechanism. *See* Paul

The reliability of reputation information, not just its dissemination, is also crucial to ensure proper incentives to cooperate, and thus several forces complement information sources to ensure their veracity. One source of guaranteeing accuracy is the composition of the DDC's arbitration board. The industry's arbitrators are experienced insiders who are extremely familiar with the nature of the industry and the difficulties involved in entering diamond contracts. Their expertise helps arbitrators understand the context within which disputes arise, distinguish meritorious from non-meritorious claims, verify the veracity of proffered evidence, and, when appropriate, estimate the appropriate damages. Additionally, the board may respond to misinformation and punish any party responsible for spreading inaccurate information about another's reputation.²⁵ Another force working to ensure the accuracy of reputation information is the rigorous set of Jewish laws that strictly regulate the information one is permitted, prohibited, and required to disclose regarding another individual.²⁶ These

Milgrom, Douglass C. North, & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 *ECON. & POL.* 1 (1990). Historically, the foremost function of all diamond bourses and their less established predecessors has always been to facilitate a flow of information about market participants and business opportunities. See Abe Michael Shainberg, *Jews and the Diamond Trade*, in *THE JEWISH DIRECTORY AND ALMANAC* 301, at 308 (1982) (describing history of diamond clubs from 15th-century Belgium). Lisa Bernstein, puts it succinctly: "The bourse is an information exchange as much as it is a commodities exchange." *Bernstein*, *supra* note 5, at 121.

²⁵ In one case, a dealer falsely accused another of stealing his stone. He later realized that he actually misplaced the stone and apologized to the dealer, but the accusation had already become common knowledge. The second dealer then brought the first before the arbitration committee for impugning his reputation, and the board ordered the false accuser to make a public apology and donate fifty thousand dollars to a Jewish charity. *Bernstein*, *supra* note 5, at 27.

²⁶ Jewish law imposes three distinct prohibitions: knowingly communicating false, negative statements about another (*motzi shem rah*), making unflattering, but true, remarks about a person for no reason (*lashon harah*), and recounting to a person gossip heard about him (*rekhilus*). See MICHAEL J. BROYDE, *THE PURSUIT OF JUSTICE AND JEWISH LAW* (1996), at 77, citing Maimonides, *Deot* 7:1-7. Thus, Jewish law forbids individuals from knowingly disseminating false and damaging information about others, and it also requires individuals to have compelling reasons for sharing information that, even if truthful, is damaging or unflattering to another. Jewish law does not, however, place excessive barriers to

religious rules and community norms help filter communications to increase their accuracy – deterring the spread of misinformation and unnecessary information – without unduly preventing the dissemination of useful information. In a world where good reputations are so critical to commercial success, and where gossip can be so damaging, these filters are important in discouraging aimless information of questionable veracity.

In sum, the DDC’s arbitrators identify merchants who have engaged in wrongdoing, and both formal and informal industry mechanisms disseminate the identities of those deserving of bad reputations. Industry and community norms then inflict a coordinated punishment against wrongdoers by foreclosing future business to those who have failed to uphold their commitments in the past. The collection of industry and community institutions has been able to sustain a \$60 billion industry despite the futility of state courts, an industry that likely would collapse if it were forced to rely on court enforcement, rather than reputation-based enforcement, of executory contracts. Could such a procompetitive venture amount to an antitrust violation?

II. THE ANTITRUST ANALYSIS: TACIT COLLUSION, ESSENTIAL FACILITIES, AND INFORMATION SHARING

It might be said that a clever antitrust attorney can find violations in the most procompetitive behavior.²⁷ In fact, finding an antitrust violation in the conduct by the DDC and its members might require very little

communicating reputation information that prevent a merchant from obtaining the information necessary to sustain his livelihood. To the contrary, Jewish law mandates the sharing of damaging yet truthful reputation information if such information would be of substantial use to the recipient, so long as it is not exaggerated, is shared only because it would aid the recipient, and is shared only to the degree necessary to assist the recipient. *See id.*, citing R. Israel Meir Kagan, *Hafetz Hayyim*, 9:1-15, 10:1-17.

²⁷ Cf. Edwin Rockefeller, *The Enduring Nature of ‘Antitrust,’* *Antitrust & Trade Reg. Rep.* (BNA) 282 (Sept. 28, 2001) (“The reason why antitrust-as-faith endures is not because it has a fixed basis in science or reason but because it does not. One wants both justice and mercy. ... If fairness is to prevail, the plaintiff wins; if efficiency is the goal, the defendant wins. The law is no guide for decision.”)

cleverness, as the industry's reputation mechanism is in tension with several doctrines in antitrust law. This section plays the part of a law student taking an exam who, having examined the facts presented in the previous section, identifies potential antitrust violations.

Group Boycotts & Tacit Collusion

Reputation mechanisms are coordinated, multilateral efforts to punish bad behavior. In this respect, they are similar to court judgments for breached contracts since both are instruments to punish individuals who deviate from their promised obligations. Sanctions administered by reputation mechanisms, however, are prospective and penalize breaching parties by foreclosing profitable opportunities in the future. Effective and credible prospective punishment, therefore, must be the product of a collective commitment by all industry members. For example, if any one diamond merchant agrees to transact with a merchant who misbehaved in the past, perhaps in exchange for a premium that is less than the profit the breaching party enjoyed from his previous breach, then the promised sanctions from misbehavior are inadequate to deter breach. To sustain cooperation, all diamond merchants must refuse to deal with individuals who have misbehaved in the past even though it means relinquishing individual opportunities for profit (and relatedly, merchants who are known to transact with parties with bad reputations must also be subject to a collective punishment).²⁸

The reputation mechanism can thus be described as a group boycott, or a horizontal agreement among diamond merchants – who are competitors

²⁸ It needs to be noted that the diamond industry has exceptions, and the industry has mechanisms that aim to distinguish between malicious breaches from breaches that are products of miscalculations or other errors. In these latter instances, the administered punishments are less unforgiving, and leading community or industry members might make efforts to rehabilitate a breaching merchant's reputation. In short, these rules are not absolute, nor should one expect them to be absolute given the frailties and lenience of human nature. But the exceptions are few and far-between, such that the impending punishment adequately deters deviation and supports equilibrium of cooperation. See Richman, *supra* note 5.

– to refuse to deal with certain industry actors. The Supreme Court has unequivocally held that such agreements to be illegal *per se*. In *Klor's v. Broadway-Hale*, in which a horizontal agreement was orchestrated to block sales to a particular retailer, the Court declared that “Group boycotts, or concerted refusals to deal with other traders, have long been held to be in the forbidden category [of restraints.]”²⁹ The Court with equal vigor has condemned horizontal agreements that arise out of industry associations that aim to boycott certain competitors who introduce alternative business practices. In *Eastern Retail Lumber Dealers Assn. v. United States*, the Court ruled against an association of lumber retailers who refused to deal with vertically integrated wholesalers,³⁰ and in *AMA v. United States*, the Court invalidated the American Medical Association’s policy (which claimed to preserve professional standards and ethics) that expelled any physician who worked for a nonprofit health maintenance organization.³¹ These rulings are part of a long line of Supreme Court Cases declaring that horizontal agreements to orchestrate group boycotts are illegal *per se*.³²

The case that is perhaps closest to the diamond industry’s boycotts is *Fashion Originators’ Guild v. FTC*, in which an association was found to violate the Sherman Act when it refused to sell to retailers that purchased from pirating competitors.³³ Even though the association claimed its practices were “reasonable and necessary” to assert their alleged rights

²⁹ *Klor's v. Broadway-Hale*, 359 U.S. 207, 212 (1959). The Court clarified in *NYNEX v. Discon* that the illegal conduct in *Klor's* was the horizontal agreement among competing manufacturers, not the vertical exclusivity demanded by one of the retailers. See *NYNEX*, 525 U.S. at 135-36.

³⁰ 234 U.S. 600, 614 (1914) (holding that a retailer who circulated a blacklist of dealers among a professional association “exceeds his lawful rights, and such action brings him and those acting with him within the condemnation of the act of Congress”)

³¹ 317 U.S. 519 (1943) (affirming conspiracy convictions under the Sherman Act).

³² See, e.g., *FTC v. Superior Court Trial Lawyers Assn.*, 493 U.S. 411, 412 (1990) (holding that *per se* rules “have the same force and effect as any other statutory commands”); *Arizona v. Maricopa County Med. Society*, 457 U.S. 332, 344 n.15 (1982) (reaffirming that group boycotts are “unlawful of themselves”); *Federal Maritime Commn. v. Aktiebolaget*, 390 U.S. 238, 250 (1968) (“[A]ny agreement by a group of competitors to boycott a particular buyer or a group of buyers is illegal *per se*.”); HERBERT HOVENKAMP, 13 ANTITRUST LAW ¶2203, n.1 (listing cases).

³³ 312 U.S. 457 (1941).

under the Copyright Act (and even though one could plausibly consider such practices to have a procompetitive purpose), the Court upheld the FTC's refusal to consider the reasonableness of the association's conduct. It concluded, in an expansive ruling, that "the reasonableness of the methods pursued by the combination ... is no more material than would be the reasonableness of the prices fixed by unlawful combination."³⁴ The Court specifically condemned the Guild for engaging in self-help, ruling that "even if copying were an acknowledged tort under the law of every state, that situation would not justify petitioners in combining together to regulate and restrain interstate commerce in violation of federal law."³⁵

The *per se* rule for group boycotts was contracted slightly in *Nynex v. Discon*, in which the Court clarified that "the *per se* rule [is] applicable in certain group boycotts."³⁶ The Court cited approvingly of the circuit court's ruling that "the *per se* rule would apply only if no pro-competitive justification were to be found,"³⁷ and it then cited Areeda & Hovenkamp to confirm that "justifications are routinely considered in defining the forbidden category" of group boycotts.³⁸ The murky rule that emerges from *Fashion Originators Guild* and *Nynex* is that group boycotts face heightened scrutiny (if not classic *per se* treatment) under the antitrust laws, that procompetitive justifications could make group refusals permissible, but that self-help efforts to protect legitimate legal interests are not excused if they rest on objectionable restraints of trade. Thus, the diamond industry's efforts to self-police legal contracts, even if such self-policing is necessary only because of court failures, and perhaps even such self-policing has procompetitive justifications, is unlikely to escape antitrust liability.

The immediate counter to the charge that the diamond dealers have organized a horizontal agreement to exclude certain rivals is, simply, that

³⁴ *Id.* at 468-69.

³⁵ *Id.* at 469.

³⁶ *NYNEX*, 525 U.S. at 135 (emphasis added).

³⁷ *Id.* at 136 (internal quotations omitted) (citing *NYNEX v. Discon*, 93 F.3d 1055, 1061 (1996)).

³⁸ *Id.* (citing 7 P. Areeda & H. Hovenkamp, *ANTITRUST LAW* ¶1510, p. 416 (1986)).

there is no actual agreement. To be sure, membership in the DDC requires signing onto the association's by-laws, which constitutes an agreement, but nothing in the by-laws prohibits members from dealing with merchants who have transgressed past contractual obligations.³⁹ But the categorical refusals to deal with individuals who have breached, despite the obvious profit opportunities for the members were to cross the boycott, indicates that each individual member works against his business interests in abiding by the group boycott. Thus, there is reason to find tacit collusion, or an implied agreement.

The Supreme Court launched the possibility that an illegal conspiracy will be inferred without direct proof of an agreement in *Interstate Circuit v. United States*.⁴⁰ Interstate Circuit, a significant movie exhibitor, asked eight competing film distributors to impose certain demands on all exhibitors in Interstate's region. Interstate's request came as a single letter that named all eight distributors as recipients, so each distributor knew the others were receiving the same demands. The distributors all acceded to Interstate's demands, which gave Interstate's first-run theatres greater exclusivity and increased both Interstate's and the distributors' profits. Even though there was no evidence that the distributors communicated directly or indirectly with each other, the Court found sufficient evidence of an illegal horizontal agreement, concluding "it was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it."⁴¹ Since the letter coincided with a significant change in the distributors' business practices, and since each distributor faced "risk of

³⁹ In fact, the DDC by-laws include a provision regarding restraints of trade: "The Organization shall not: adopt any resolution, rule, regulation or By-Law which illegally attempts to restrain trade or violate the law." *DDC By-Laws*, Art. XVII. This provision was added to the DDC by-laws as part of a consent decree that followed an antitrust action brought by the Department of Justice, *see infra* at notes 135-144 and accompanying text. Adding the Restraint of Trade provision did not change the DDC's method of operation, and thus has little impact on whether, in fact, the DDC and its members have been executing an illegal restraint of trade.

⁴⁰ 306 U.S. 208 (1939).

⁴¹ *Id.* at 226.

substantial loss” if it pursued these new practices unilaterally, the Court continued,

we are unable to find in the record any persuasive explanation other than agreed concert of action, of the singular unanimity of action on the part of the distributors.... It taxes credulity to believe that the several distributors would, in the circumstances, have accepted and put into operation with substantial unanimity such far-reaching changes in their business methods without some understanding that all were to join...⁴²

Areeda & Hovekamp state the *Interstate Circuit* principle succinctly: “if rational defendants would not act without mutual assurances of common action, then the act proves that such assurances took place.”⁴³

The Court’s later rulings in *Theatre Enterprises v. Paramount Film Corp.*⁴⁴ and *Brooke Group v. Brown & Williamson*⁴⁵ clarified that merely parallel conduct among rivals does not enough to find an illegal agreement, and thus subsequent cases have looked for what have been called “plus factors” that might indicate where parallel behavior amounts to a conspiracy.⁴⁶ Plus factors that have been found to transform parallelism into conspiracy, or have allowed a jury to do so, include frequent announcements of important information and future action,⁴⁷ mechanisms

⁴² *Id.* at 222.

⁴³ PHILIP AREEDA & HERBERT HOVENKAMP, 4 ANTITRUST LAW, at 188.

⁴⁴ 346 U.S. 537, 541 (1954) (“[C]onscious parallelism has not yet conspiracy out of the Sherman Act entirely.”)

⁴⁵ 509 U.S. 209, 227 (1993) (“Tacit collusion, sometimes called ... conscious parallelism, describes the process, *not in itself unlawful*, by which firms in a concentrated market might in effect share monopoly power...”) (emphasis added).

⁴⁶ *See, e.g.*, *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 122 (3d Cir. 1999) (“Because the evidence of conscious parallelism is circumstantial in nature, courts are concerned that they do not punish unilateral, independent conduct of competitors. They therefore require that evidence of a defendant’s parallel pricing be supplemented with ‘plus factors.’”) Areeda and Hovenkamp describe the “inelegant term” of plus factors to mean “the additional facts or factors required to be proved as a prerequisite to finding that parallel action amounts to a conspiracy.” ANTITRUST LAW, *supra* note 43 at ¶1433e.

⁴⁷ *Petroleum Products Antitrust Litigation*, 906 F.2d 432 (9th Cir. 1990) (concluding that advance announcements of price increases, combined with parallel pricing, supports a reasonable inference of an illegal conspiracy).

to share information among rivals,⁴⁸ and policies that standardize industry practices.⁴⁹

The reputation mechanism at work in the diamond industry is a clear instance of parallel conduct that is not economically rational without an agreement, and the industry is home to many plus factors that would lead to a finding of tacit collusion. The arbitration board's identification and announcement of a particular individual amounts to an announcement of a particular boycott target. The DDC wall, and the DDC as a gathering place for rivals and a central conduit for information, offer useful mechanisms to share information and coordinate concerted action. And the rigid industry practices for orchestrating and adjudicating sales impose a standardization that makes deviations noticeable and easy to spotlight. In short, the diamond industry offers mechanisms that enable merchants to tacitly conspire to collectively boycott certain industry rivals. Significantly, these features – concerted action to boycott particular actors and information mechanisms to enable such concerted action – are typical in many reputation mechanisms, and if the DDC is found to violate the Sherman Act, then other reputation mechanisms might be in violation as well.

Positive Externalities and the Associated Press Doctrine

Even if there were no horizontal agreement to illegally boycott certain competitive targets, the DDC is a joint venture with by-laws to which members (who compete with each other) agree, and is clearly the product of a horizontal agreement among competitors.⁵⁰ The DDC's rules, and the substance of the agreement that amounts to the creation of the DDC, are therefore subject to antitrust scrutiny normally applied to joint ventures and industry associations.⁵¹

⁴⁸ *Boise Cascade Corp. v. FTC*, 637 F.2d 573 (9th Cir. 1980).

⁴⁹ *See, e.g., C-O-Two Fire Equipment Co. v. United States*, 197 F.2d 489 (9th Cir.).

⁵⁰ Deleted text: The DDC might not be responsible for all of the diamond merchants' conduct, and thus the DDC may not violate the Sherman Act even if its members do.

⁵¹ It should be noted that, as part of a settlement to a previous antitrust action brought by the Department of Justice, *see infra* at 135-145 and accompanying text, the DDC included in its by-laws a "Restraint of Trade" pledge that it shall not "adopt any resolution, rule,

Characterizing the DDC as a joint venture removes it from *per se* scrutiny. Joint ventures are generally judged under the rule of reason, with several courts noting that it is inappropriate to apply the automatic *per se* rule to such purportedly procompetitive collaborations.⁵² Accordingly, the DDC might be characterized as a collaborative agreement between competing diamond merchants that is founded with procompetitive purposes and achieves certain efficiencies, and therefore the proper antitrust analysis would weigh the DDC's procompetitive benefits against any ancillary and unavoidable anticompetitive consequences.⁵³

To be sure, the DDC could identify many procompetitive effects from offering competing diamond dealers a central bourse with uniform industry rules and skilled arbitration panels.⁵⁴ The DDC also disseminates market information among merchants and creates a central trading floor, so market prices are well known, and like other bourses, the DDC enables buyers and sellers to find each other at low transaction costs, which is especially important for diamond sales where specialized preferences in-person inspection are important.⁵⁵ These and similar benefits of industry associations have been recognized by the Supreme Court as legitimate reasons for competitors to cooperate: the Court noted procompetitive benefits from uniform industry rules and coordination in *United States v. Terminal Railroad Assn.*,⁵⁶ *NCAA v. Board of Regents of the Univ. of*

regulation, or By-Law which illegally attempts to restrain trade or violate the law." DDC By-Laws, Art. XVI. Of course, competitors who agree not to violate the antitrust laws are not immunized from antitrust liability.

⁵² See, e.g., *Northwest Wholesale Stationers*, 472 U.S. at 284; *Broadcast Music, Inc. v. Columbia Broadcasting, Inc.*, 441 U.S. 1 (1979).

⁵³ See *California Dental Ass'n v. FTC*, 526 U.S. 756, 786-88 (Breyer, J., dissenting).

⁵⁴ On the specific efficiencies created by specialized contract rules, tailored arbitration procedures, and arbitration by industry insiders, see Bernstein, *supra* note 5.

⁵⁵ See Barak Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328-67 (2004) for the importance of the matching process.

⁵⁶ 224 U.S. 383, 403 (1912) (citing positive elements of railroad-transfer station consolidations, akin to a "public utility").

Oklahoma,⁵⁷ and *Allied Tube & Conduit Corp. v. Indian Head*,⁵⁸ recognized sizeable efficiencies from centralized systems of communication and information in *Silver v. NYSE*⁵⁹ and *Associated Press v. United States*,⁶⁰ and showed deference to trade association procedures and industry practices in *Pacific Stationary & Printing v. Northwest Wholesale Stationers*⁶¹ and *Broadcast Music v. CBS*.⁶²

However, as many of these cases illustrate, the benefits from industry-wide cooperation might themselves invite antitrust scrutiny if certain competitors are left out of the productive collaboration. If the joint venture is designed with an open infrastructure, such that all qualifying parties may join, and if the joint venture enjoys substantial market power and exhibits positive externalities, such that social welfare is increased with the addition of each additional competitor and such that competitors find it difficult or impossible to compete if left out of the organization, then the Sherman Act might prohibit the joint venture from excluding certain members. In *Associated Press*, for example, the Court found that newspapers excluded from the AP's shared wire service were unable to compete with the AP's members, and it concluded that the joint venture's restrictive membership policy stifled competition.⁶³ Similarly, in *Silver* and

⁵⁷ 468 U.S. 85, 101 (1984) ("What the NCAA and its member institutions market in this case is competition itself—contests between competing institutions. Of course, this would be completely ineffective if there were no rules on which the competitors agreed to create and define the competition to be marketed.")

⁵⁸ 486 U.S. 492, 500-01 (1988) (holding that "private standards can have significant procompetitive advantages" when appropriate procedures are followed).

⁵⁹ 373 U.S. 341, 366 (1963) (citing Great Depression as example of "how essential it is that the highest ethical standards prevail as to every aspect of the Exchange's activities").

⁶⁰ 326 U.S. 1 (1945) (noting the competitive superiority of collaborating and sharing news reporting)

⁶¹ 472 U.S. 284, 296 (1985) (recognizing that "cooperatives must establish and enforce reasonable rules in order to function effectively").

⁶² 441 U.S. 1, 23-24 (1979) (finding that ASCAP's "blanket license cannot be wholly equated with a simple horizontal arrangement among competitors").

⁶³ *Associated Press*, 326 U.S. at 9 ("The joint effect of these By-Laws is to block all newspaper non-members from any opportunity to buy news from AP [and] impeded the growth of competing newspapers."); see also *SCFS v. Visa USA*, (10th Cir. 1994) ("[The

Allied Tube, the Court scrutinized a joint venture's decision-making structure, in *Silver* prohibiting the NYSE from excluding a member without evidence that its procedures and membership criteria were pursuant to procompetitive objectives⁶⁴ and in *Allied Tube* invalidating an association vote to set industry standards on account of one interested party corrupting the election.⁶⁵ Trade associations that play important roles in managing an industry's operation, whether setting industry rules or controlling access to essential facilities, may not avoid antitrust scrutiny when deciding to exclude certain members.

These cases suggest that the DDC's membership practices would invite scrutiny. The efficiencies of consolidating information and creating a central locale for exchange give DDC members a substantial advantage over nonmembers. Perhaps more important, membership gives merchants access to the DDC arbitration panels to enforce their agreements,⁶⁶ and conversely, a member may credibly commit to a contractual obligation more easily than nonmembers because members are subject to the arbitrators' rulings and prohibited from invoking alternative mechanisms to resolve disputes.⁶⁷ The DDC's framework thus creates positive externalities with increased membership such that expanding membership increases industry information and broadens the reach and effectiveness of the DDC's arbitration panel for everyone. Not only does DDC membership advantage the member over the nonmember, but broad membership benefits everyone,

AP's] news gathering and dissemination capacity could not be duplicated and represented in and of itself a limitation on nonmembers.")

⁶⁴ *Silver*, 373 U.S. at 348, 350, n.40 (finding removal of telephone connections to traders' office deprived traders of "valuable business service which they needed in order to compete effectively as broker-dealers in the over-the-counter securities market").

⁶⁵ *Allied Tube*, 486 U.S. at 497 ("Petitioner alone recruited 155 persons [...] and] also paid over \$ 100,000 for the membership, registration, and attendance expenses of these voters.... None of them spoke at the meeting to give their reasons for opposing the proposal to approve polyvinyl chloride conduit. Nonetheless, with their solid vote in opposition, the proposal was rejected and returned to committee by a vote of 394 to 390.").

⁶⁶ The DDC by-laws give each member the right to file a complaint and request a hearing before the DDC arbitrators. Nonmembers do not have that right. See DDC By-laws, at Article XII, Sec.1a.

⁶⁷ *Id.* at Article XII, Sec.1a; Article III, Sec.2b.

and the DDC presents itself as the home to all, not just a selection, of the industry's important merchants.⁶⁸

Therefore, antitrust law likely imposes restraints on the DDC's ability to expel members. Open associations with positive externalities and collective market power – associations that are subject to the greatest antitrust scrutiny⁶⁹ – are generally permitted to expel members, even if expulsion puts the former members at severe competitive disadvantages, so long as the expulsion is pursuant to procompetitive objectives⁷⁰ and there are no available alternatives to expulsion that could reasonably satisfy those objectives.⁷¹ The interesting feature of exclusion from the DDC, however, is that the punishment imposed is not merely the denial of useful resources that are available to members. Rather, the primary consequence of expulsion is that it triggers a denial of future business. Both expulsion from and denied entry to the DDC are damaging because they are evidence that individual lacks a credible history of reliable and trustworthy behavior. DDC membership is necessary to signal credibility, and denial of membership is a signal that reverberates across throughout the industry.

⁶⁸ Although prospective members must apply for membership, and their admission is subject to a review by current members, the by-laws state that membership is open to all individuals engaged in the diamond trade. Presumably the positive externalities are subject to physical capacity constraints, but nothing in the by-laws indicate a ceiling to membership, though the DDC has flirted with plans to move to a larger facility. See Charles V. Bagli, *Turf Battle Looms in the Diamond District*, N.Y. TIMES Nov. 5, 2006, at 40.

⁶⁹ See AREEDA & HOVENKAMP, ¶2220a.

⁷⁰ See *Northwest Wholesale Stationers*, 472 U.S. 284, 296 (1985) (holding that “[t]he act of expulsion from a wholesale cooperative does not necessarily imply anticompetitive animus” because such organizations “must establish and enforce reasonable rules in order to function effectively.”). These procompetitive justifications to limit membership include preventing free riding and compelling optimal investments from members, see *SCFC ILC v. Visa USA*, 36 F.3d 958, 961 (10th Cir. 1994) (accepting the free rider justification to exclude Dean Witter from the Visa credit card network); see AREEDA & HOVENKAMP, ¶2223 for a critique of the Tenth Circuit's discussion of the free rider defense.

⁷¹ See *SCFC ILC*, 36 F.3d at 996 (permitting exclusion of Dean Witter from the Visa network because there was no less restrictive alternative available since membership shares access to confidential proprietary information).

Consequently, the antitrust question becomes whether excluding an individual because of past bad behavior, or the absence of a proven track record, is a procompetitive policy. Judging exclusively on the traditional antitrust standards of prices and output,⁷² the answer would have to be no. Additional members would increase supply and bring more price competition, but more important, since the network enjoys positive externalities from increases in membership, additional members would benefit both consumers and the other members whereas excluded merchants are unable to offer a competitive alternative. The DDC policy of exclusion, and the harsh consequences that follow from that policy, is a legitimate procompetitive justification only if the industry rules are necessary (not just to maximize output and price competition, but also) to secure exchange. It means that the DDC's punishments would perform an extralegal function that is made necessary by the failure of public courts.

Is a "court failure" argument a legitimate procompetitive justification under current antitrust law? The case that is most on-point is *Fashion Originators' Guild*, where the Court squarely invalidated an association's self-help efforts to punish allegedly tortuous conduct.⁷³ Decrying the Guild as an "extra-governmental agency," the Court refused to consider whether the group boycott had procompetitive justifications.⁷⁴ The diamond industry's systems of reputations, like the enforcement mechanisms designed by the Guild, are designed to protect legal rights that

⁷² Traditional antitrust analysis is devoted to maximizing economic welfare, which pays exclusive attention to prices and output. *See* *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 784-85 (1999) (Breyer, J., concurring in part and dissenting in part) (stating that a restraint's likely effect on prices will determine whether it is anticompetitive); *NCAA v. Bd. of Regents*, 468 U.S. 85, 107-08 (1984) ("Restrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit."); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979) ("[O]ur inquiry must focus on . . . whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output . . .").

⁷³ *Fashion Originators' Guild v. FTC*, 312 U.S. 457 (1941).

⁷⁴ *Id.* at 465 (finding group of manufacturers "in reality an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce, and provides extra-judicial tribunals for determination and punishment of violations, and thus 'trenches upon the power of the national legislature and violates the statute.'" (*quoting* *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 242 (1899))).

are not reliably secured by state courts. Unless the language in *Fashion Originator's Guild* is modified,⁷⁵ the DDC's efforts to protect its members' legitimate contractual rights—efforts that are far more effective than what those members could secure in public courts—would likely be without a recognized procompetitive justification.

In sum, the economics of the diamond industry indicate that the DDC is an open procompetitive joint venture with positive externalities, and its membership policies are accordingly subject to heightened antitrust scrutiny. The *Associated Press* doctrine therefore permits the DDC to exclude members only if exclusion is pursuant to a procompetitive justification, yet the Supreme Court has not yet recognized extralegal punishment of breaching contracts as a valid justification. In theory, diamond merchants may enforce those rights in state court, and the Court might be hesitant to sanction extralegal punishments as severe as exclusion when exclusion also has anticompetitive consequences on prices and output.⁷⁶ It would seem that the DDC's membership policies would survive antitrust scrutiny only if it invokes efficiency rationales on grounds that explicitly acknowledge the efficiencies of private enforcement over public ordering in state courts.

Sharing Information and Facilitating Anticompetitive Practices

Even if the DDC's membership policies were found to survive antitrust scrutiny, and if the joint venture were permitted to exclude merchants who do not comply with the dictates of the DDC arbitration

⁷⁵ *Id.* (“[E]ven if copying were an acknowledged tort under the law of every state, that situation would not justify petitioners in combining together to regulate and restrain interstate commerce in violation of federal law.”)

⁷⁶ Another reason the Supreme Court might hesitate before authorizing the industry to have such latitude to police itself with such severe punishments is that it might be hard to distinguish exclusion that pursue potentially procompetitive consequences from naked exclusion pursuant to undeniably anticompetitive consequences. The case of Martin Rappaport might fall into the latter category, when the DDC terminated his membership for distributing a newsletter that published market prices for assorted stones. Rappaport appealed to the Federal Trade Commission, which terminated its investigation after Rappaport and the DDC reached a settlement.

board, the DDC might still violate the Sherman Act if it coordinates practices that facilitate anticompetitive collusion. In certain cases, agreements to implement “facilitating practices” can amount to a Sherman Act violation.

A common facilitating practice that has been found to violate the Sherman Act is an agreement between competitors to exchange information on prices or output. The coordinated exchange of such information between competitors draws scrutiny because it enables illegal collusion even in the absence of an explicit agreement to collude. For example, the Supreme Court in *American Column & Lumber v. United States*⁷⁷ and *United States v. Linseed Oil*⁷⁸ found Section 1 violations where industry associations disseminated information on price and sales, including delivery charges. The Court concluded in both cases that agreements to exchange such information were little more than elaborate price fixing agreements designed “to bring about a concerted effort to raise prices regardless of cost or merit.”⁷⁹ The case law on such “facilitating practices” generally scrutinizes the effects of information sharing and its impact on anticompetitive outcomes, paying attention to market power, uniformity of responses, product homogeneity, and other factors that ease collusion.⁸⁰ The Court is especially suspicious of agreements to exchange information when they are deemed to trigger conduct that amounts to a *per se* violation, such as agreements to fix prices⁸¹ and output.⁸²

Accordingly, the Supreme Court has also condemned horizontal agreements to exchange information when such agreements facilitate a *per se* illegal group boycott. In *Eastern States*, where the Court found an illegal group boycott by retailers against vertically integrated suppliers, the Court ruled that the mere circulation of a list of wholesalers who engaged in retail

⁷⁷ 257 U.S. 377 (1921).

⁷⁸ 262 U.S. 371 (1923).

⁷⁹ 257 U.S. at 409.

⁸⁰ AREEDA & HOVENKAMP, ANTITRUST LAW, ¶2112.

⁸¹ *Id.* at ¶2112c (collecting cases).

⁸² *See, e.g.,* Hartford Empire Co. v. United States, 323 U.S. 386 (1945) (condemning a horizontal agreement to share production “forecasts” that triggered output quotas).

sales was enough to violate the Sherman Act.⁸³ Even though the practice of distributing the names of targeted firms was little more than an agreement to disseminate of information, the Court ruled

There can be but one purpose in giving the information in this form to the [retailers]... These lists were quite commonly spoken of as blacklists... He is blind indeed who does not see the purpose in this report to put the ban upon wholesale dealers.⁸⁴

The DDC constitutes an agreement to exchange information that performs precisely the same purpose as the “blacklist” in *Eastern States*. One of the DDC’s primary functions is to disseminate the names of individuals who have failed to live up to their past agreements, and the motivation for doing so is clearly to provoke a collective refusal to deal. Even the methods of disseminating the DDC’s information are inflammatory: a picture of each wrongdoer is posted publicly, not unlike *Wanted* posters in the Old West, with the details of the breach and the amount owed.⁸⁵ Even if the DDC does nothing more than disseminate this information, this joint venture to share information among competitors might amount to an antitrust violation since it is so intimately intertwined with a concerted refusal to deal. The information on past behavior is distributed with the purpose, and has the uniform effect, of triggering a boycott that may be a *per se* violation.⁸⁶

Perhaps the best defense of the DDC’s information sharing lies in *Cement Manufacturers’ Protective Assn. v. United States*, in which the Supreme Court permitted an association of cement manufacturers to investigate whether, and then to announce when, buyers of concrete were adhering to their purchase contracts.⁸⁷ The Court concluded that the collective investigation and sharing of information on customer compliance

⁸³ 234 U.S. 600 (1914).

⁸⁴ *Id.* at 608-09.

⁸⁵ The attack on one’s character is unmistakably sweeping, reminiscent of Casio’s lament of the downfall of his own reputation, *see supra* note 2.

⁸⁶ *See supra*, part II.A.

⁸⁷ 268 U.S. 588 (1925).

was reasonable to avoid purchaser fraud.⁸⁸ However, as much as *Cement Manufacturers* recognizes that preventing fraud might be a legitimate purpose for exchanging information, the consequences of exchanging information among diamond dealers is far more sweeping. In *Cement Manufacturers*, the consequence of investigating and finding fraud was to cancel the individual contract that the purchaser was defrauding,⁸⁹ whereas the DDC's dissemination of past fraud is designed to trigger a sweeping boycott and is much more closely connected to the illegal collusion the Sherman Act is designed to prevent.

In sum, if the DDC can be construed as an agreement among competitors to share information about individual merchants, and if the information-sharing agreement is designed to trigger a group boycott, then the joint venture to share information might amount to an antitrust violation. Of course, this agreement to gather and disseminate certain information on past conduct is necessary to support a reputation mechanism, and without this agreement, a reputation mechanism would not be sustainable. In fact, all reputation mechanisms rely on the dissemination of information on past conduct, and that dissemination is always designed to inform and influence the subsequent conduct of economic actors. So if the DDC's information mechanisms violate the Sherman Act, then other reputation mechanisms might as well.

III. INSTITUTIONAL EFFICIENCIES AS AN ANTITRUST DEFENSE

The above section suggests that a formal application of current antitrust law presents a number of alternative paths in which New York's

⁸⁸ *Id.* at 603-04 (“[W]e cannot regard the procuring and dissemination of information which tends to prevent the procuring of fraudulent contracts ... as an unlawful restraint of trade even though such information be gathered and disseminated by those who are engaged in the trade or business principally concerned.”)

⁸⁹ *Id.* at 596-97. The Court recognized that cancellation of the contract led to a reduction of cement supplied, and thus had an effect on output, but this consequence was negligible and did not transfer the agreement into one that restricted output. *Id.* at ___

diamond dealers and the DDC might violate the Sherman Act. Of particular import is the possible application of the rule in *Fashion Originators Guild*, which prohibits horizontal refusals to deal even if the restraints enjoy procompetitive justifications or are designed to vindicate legal rights.⁹⁰ If diamond merchants are equally limited in justifying their conduct, then antitrust law might foreclose an efficiency analysis. And even if either a rule of reason or a less sweeping *per se* rule applied, and the industry were permitted to articulate procompetitive justifications, the diamond merchants' concerted action might still violate the Sherman Act unless antitrust law permits collective self-help when courts fail and recognizes the institutional efficiencies that make group boycotts superior to alternative enforcement mechanisms.

On its face, prohibiting the diamond industry's use of reputation mechanism seems to transgress what might be the prime directive of antitrust law: that antitrust does not condemn agreements that enhance consumer welfare.⁹¹ The industry relies on a reputation mechanism because public courts are unable to enforce diamond credit sales, and therefore, the concerted refusal to appear to support the \$60 billion-a-year industry. If the diamond industry reveals that horizontal group boycotts can promote consumer welfare, then the *per se* rule—or even heightened antitrust scrutiny—is not appropriate for these horizontal restraints.⁹²

However, even under a rule of reason analysis, where procompetitive justifications were permitted, the mere existence of the

⁹⁰ As was previously noted, the Supreme Court has reiterated recently that the *per se* rule still applies to certain horizontal group boycotts. See *NYNEX v. Discon*, *supra* note 6. See also *FTC v. Superior Court Trial Lawyers Assoc.*, 493 U.S. 411 (1990) (“[W]hile the *per se* rule against price fixing and boycotts is indeed justified in part by administrative convenience, ... the *per se* rules also reflect a long-standing judgment that the prohibited practices by their nature have a substantial potential for impact on competition.”) (internal citations and quotations omitted).

⁹¹ See *supra*, note 7.

⁹² See *Leegin Creative Leather Prods. v. PSKS, Inc.*, 127 S. Ct. 2705, 2720 (2007) (holding that “[r]esort to *per se* rules is confined to restraints, like those mentioned, ‘that would always or almost always tend to restrict competition and decrease output.’) (quoting *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, at 723).

industry is an inadequate articulation of the general benefits of group boycotts. The question remains whether the industry's concerted refusal to deal is a desirable (in antitrust terms, efficient) mechanism to support diamond exchange, especially when compared to alternatives. This question arises from the observation that the merchants' horizontal group boycott is *not necessary* to support exchange. The industry's reputation mechanism is not the only conceivable privately-administered instrument that can assure transactional certainty, and if the industry were prohibited from organizing a reputation mechanism that enforces contractual compliance, the industry would seek alternative mechanisms to support exchange rather than collapse.

One governance strategy that has proven to effectively secure diamond transactions is to internalize transactions into a firm, where managers can tightly supervise employees. This strategy is utilized successfully at other locations in the industry's distribution chain, with most of the world's diamond mining and the large-scale diamond cutting occurring within vertically integrated firms. These large-scale operations have many employees and manage large quantities of diamonds that regularly are in the possession of workers who do not own the stones.⁹³

⁹³ It should be noted that many of the large-scale mining and cutting operations resort to rather coercive and intrusive security mechanisms to govern these internal transactions. Many mine operators confine all employee handling of diamonds to discrete physical locations where x-ray machines and other tools guard against employee theft. Some mines have earned notorious reputations for intrusive employee monitoring, with South Africa's Truth and Reconciliation Committee criticizing De Beers-operated mines for forcing their employees to live away from their families and in grim hostels on the mining site. Alex Duval Smith *The Gem Trail*, THE INDEPENDENT, Feb. 13, 1999, pg. 18. (In De Beers' defense, Harry Oppenheimer, who controlled the company from 1954-1994, was an outspoken critic of Apartheid as a member of South Africa's Parliament. See Donald G. McNeil, Jr., *A Diamond Cartel May Be Forever*, NEW YORK TIMES Jan. 12, 1999, at C1.) Worse, the Revolutionary United Front, the rebel movement that controls several diamond mines in Sierra Leone, brutally restrict the movement of thousands of men and boys, who some have labeled "today's slaves." Andrew Parker, Mark Huband and Francesco Guerrera. *The Deadly Scramble for Diamonds in Africa*, FINANCIAL TIMES July 10, 2000. Such intense monitoring is, in part, a response to creative attempts at theft that include workers swallowing diamonds or hiding them in the heels of their shoes. One racket at a

Mechanisms available within these firms have effectively prevented theft and flight, and these same mechanisms should be available to New York's merchants. In short, rather than relying on a voluntary association that spreads information among the middlemen who broker and sell diamonds to each other, 47th Street's merchants could instead rely on an integrated firm to manage the distribution of diamonds from producers to retailers.

Therefore, if antitrust is concerned about efficiency and consumer welfare, it would determine the legality of the diamond industry's concerted group boycotts based on the institutional efficiency of the reputation mechanism. Just as antitrust recognizes "market failure" justifications for

Namibian mine involved pigeon fanciers who recruited miners to bring homing pigeons into the mine in lunchboxes and strap diamonds to their feet. *See* Smith, *supra*.

Diamond cutting and polishing factories also successfully use firm-based monitoring mechanisms. Small diamond cutting firms have enjoyed successful monitoring of employees for generations. A series of fascinating examples occurred in the years during World War II, when some of Antwerp's and Amsterdam's Jewish diamond merchants and factory owners fled Nazi persecution. Many landed in nations, such as Cuba and Mexico, that previously had no history with the diamond trade. Nonetheless, many of these refugees were able to establish small cutting operations by employing local workers. *See* David Federman, *Diamonds and the Holocaust*, MODERN JEWELER, Mar. 1986. However, most diamond cutting occurs in large factories in India, Thailand, and China that employ inexpensive, low-skilled labor. These large factories employ governance mechanisms that resemble the careful employee monitoring that occurs in diamond mines, and though they successfully manage theft, some factories have also earned notorious reputations for their treatment of employees. A major diamond labor union recently issued a writ complaining that thousands of diamond cutters in Gujarat, India worked in conditions that violated Indian labor laws. One advocate described their employment conditions as "bonded labor." "Notice to Labour Commission on Diamonds Workers' Plight" THE TIMES OF INDIA September 16, 2001. Indian cutters are also subject to severe sanctions by their employers if suspected of stealing diamonds. *See, e.g.,* "Diamond Cutter Beaten to Death" THE TIMES OF INDIA May 29, 2000.

Other diamond activity where agents are intrusively monitored includes diamond grading, such as is done by the Gemological Institute of America (GIA), where gemologists examine and grade diamonds within a closed, tightly secured complex. However comprehensive the GIA's security system is, it does not raise the humanitarian concerns raised by some mines and factories, and were the industry to vertically integrate in New York, its governance mechanisms would likely resemble those employed by the GIA.

certain collaborations,⁹⁴ it should also recognize a “court failure” justification that would evaluate institutional alternatives in light of a public court’s failure to offer the contractual security a merchant group requires. The requisite antitrust scrutiny would thus incorporate transaction costs into the efficiency analysis, move beyond the traditional and narrower antitrust inquiry into price and output, and instead employ comparative institutional analysis to determine the relative efficiencies of alternative mechanisms that privately govern transactions. To do so, it might consult Transaction Cost Economics (TCE), which studies alternative mechanisms to secure transactions, including vertical integration and “hybrids” such as reputation mechanisms, and examines and assesses their relative efficiencies.⁹⁵

Transaction Cost Economics and Antitrust: A Background

At its core, Transaction Cost Economics is the study of economic organization. It understands alternative organizational forms – the firm, the market, public bureaus, regulated franchises, and assorted hybrids – as efforts to mitigate transactional hazards. It approaches nonstandard and elaborate business practices as deliberate efforts to economize on transaction costs and achieve efficient governance.⁹⁶

Transaction Cost Economics has had a long, fairly rocky, but ultimately influential history in antitrust policy. When TCE was developing market failure explanations for vertical restraints in the 1960s and 1970s, neoclassical price theory dominated antitrust policymaking. Enforcement agencies “pursued the dictates of price theory with a vengeance,”⁹⁷ leading them to presume that most vertical restraints were exercises of market

⁹⁴ See, e.g., *Cal Dental Assn. v. Fed Trade Comm.*, 526 U.S. 756 (1999).

⁹⁵ For a modern overview of Transaction Cost Economics, see OLIVER WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* (1996). For a comparative assessment of how vertical integration minimizes transaction costs in relation to “hybrids,” see *id.* at 93-119. For a transaction cost examination of reputation mechanisms, see *id.* at 151-58.

⁹⁶ *Id.*, especially at 3, 12, 54.

⁹⁷ Alan J. Meese, *Raising Rivals Cost: Can the Agencies Do More Good Than Harm?* 12 *GEO. MASON L. REV.* 241, 260. For a useful discussion of the dominance of neoclassical price theory in antitrust policymaking in the 1960s, see Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 *U. ILL. L. REV.* 77 (2003).

power.⁹⁸ Policymakers, led by Donald Turner, an unabashed price theorist and then-head of the Antitrust Division of the Department of Justice, regularly condemned vertical agreements such as tying arrangements, exclusive dealing contracts, territorial agreements, and vertical mergers, concluding that they were evidence of, and inefficient exercises of, monopoly power. Under Turner's reign, antitrust enforcement in these areas grew to a zenith,⁹⁹ and he was famously quoted to have said, "I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law."¹⁰⁰ Thus the "inhospitality tradition" to vertical restraints, and to TCE-based justifications for such restraints, was coined.

The inhospitality tradition reached its culmination in the Department of Justice's 1968 merger guidelines, which forbade mergers between parties with nominal market power (Oliver Williamson, the pioneer of TCE, quipped that "mergers were challenged that did not remotely pose anticompetitive concerns."¹⁰¹) Over time, however, this hostility to vertical restraints could not withstand growing skepticism. Ronald Coase in 1972 lamented the myopia in the economic theory, saying "when an economist finds something – a business practice of one sort or another – that he does

⁹⁸ The foundation of this approach to neoclassical price theory was motivated by Joe Bain's emphasis on market structure, which held that vertical restraints were evidence of monopolists aiming to expand monopoly power. See JOE S. BAIN, *INDUSTRIAL ORGANIZATION* (1968, 2d ed.), at 381. The 1968 Merger Guidelines confidently noted that "market structure generally produces economic predictions that are fully adequate." ANTITRUST DIV., U.S. DEP'T. OF JUSTICE, *MERGER GUIDELINES* (1968), at 6882.

⁹⁹ It was at around this time that Justice Potter Stewart remarked, "the sole consistency that I can find ... in [merger] litigation under Section 7 is that the Government always wins." *United States v. Von's Grocery Co.*, 384 U.S. 270, 301 (1966) (Stewart, J., dissenting). Oliver Williamson described antitrust enforcement at this time as "overconfident and shrill." See *MECHANISMS OF GOVERNANCE*, *supra* note 89, at 306.

¹⁰⁰ Meese, *supra* note 97 (citing Donald F. Turner, *Some Reflections on Antitrust*, 1966 N.Y. ST. B.A. ANTITRUST L. SYMP. (1966))

¹⁰¹ Oliver Williamson, *Transforming Merger Policy: The Pound of New Perspectives*, 76 *AMER. ECON. REV.* 114, 116 (1986). The Guidelines, for example, forbade a supplying company with 10% market share from acquiring a purchasing company with 6% market share. *GUIDELINES*, *supra* note 98 at 6886-87.

not understand, he looks for a monopoly explanation.”¹⁰² In addition, TCE and other theories began generating benign justifications for vertical restraints, especially for vertical mergers. Oliver Williamson’s 1975 *Markets and Hierarchies*, which perhaps marked the official launch of TCE and led scholars and antitrust policymakers “Toward a New Institutional Economics,”¹⁰³ pressed that “the policy implications of [institutional economics] that are of principal concerns are those having to do with antitrust.”¹⁰⁴ To the degree that policymakers will consult institutional economics for matters spanning vertical integration, conglomerate organization, dominant firms, and oligopoly, Williamson suggested that “antitrust enforcement will proceed more selectively in the future.”¹⁰⁵ The transaction cost approach soon made its way into the world of legal scholars. Robert Bork adopted the TCE approach towards understanding vertical mergers, remarking that “What antitrust perceives as a merger, and therefore a suspect and probably traumatic event, is merely an instance of replacing a market transaction with administrative direction because the latter is believed to be a more efficient method of coordination.”¹⁰⁶ And Frank Easterbrook, shortly before his appointment to the bench, was equally embracing of the TCE template when he asserted that “the dichotomy between cooperation inside a ‘firm’ and competition in a ‘market’ is just a convenient shorthand for a far more complicated continuum.”¹⁰⁷

Criticism of the applied price theory approach, and the success of TCE and other institutional approaches, led the Department of Justice in

¹⁰² Ronald H. Coase, *Industrial Organization: A Proposal for Research*, in *ECONOMIC RESEARCH: RETROSPECT AND PROSPECT* (V.R. Fuchs ed., 1972).

¹⁰³ OLIVER WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975). Chapter 1 is entitled, “Toward a New Institutional Economics.”

¹⁰⁴ *Id.* at 258.

¹⁰⁵ *Id.*

¹⁰⁶ ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978), at 227. Bork is significantly more expansive than Williamson, remarking that “Antitrust’s concern with vertical mergers is mistaken.... The vertical mergers that the law currently outlaws have no effect other than the creation of efficiency.” *Id.* at 226.

¹⁰⁷ Frank Easterbrook, *The Limits of Antitrust*, 63 *TEX. L. REV.* 1 (1984). To be fair, this remark (like Bork’s, *supra*) embraces an approach that began with Ronald Coase’s seminal article, *The Nature of the Firm*, 4 *ECONOMETRICA* 386 (1937), and predated TCE.

1982 to substantially revise its guidelines for vertical mergers. The revised *Guidelines* expressly reflected transaction cost reasoning, with nonstandard forms of organization no longer creating a presumption of anticompetitiveness.¹⁰⁸ Further revisions to the *Guidelines* in 1984 made antitrust policy even more permissive towards vertical mergers, holding that vertical mergers are problematic only where the market structure would permit strategic behavior, such as an instance in which a merger would cause a barrier to entry in one of the affected markets.¹⁰⁹ The Department of Justice has not revised its vertical merger guidelines since 1984, and it might be safely said that Transaction Cost Economics and related organizational perspectives have permanently transformed antitrust policy towards vertical mergers, and more generally towards vertical agreements.¹¹⁰

Transaction cost lessons for horizontal agreements, however, are less obvious. Horizontal collusion remains the paradigmatic antitrust concern,¹¹¹ and the agreements that bind competing diamond dealers are quintessentially horizontal. Even though collusion in the diamond industry is designed to solve a contracting problem, and even though TCE is principally an effort to understand contracting problems, the case of industry-wide collusion of diamond merchants falls outside the classical TCE framework. Transaction cost logic still applies, and in fact it illuminates why collusion in the diamond industry is both procompetitive

¹⁰⁸ CITE TO 1982 GUIDELINES, WITH PARENTHETICAL (IF ONE IS AVAILABLE)

¹⁰⁹ ANTITRUST DIV., U.S. DEP'T. OF JUSTICE, MERGER GUIDELINES (1984), at 4.21.

¹¹⁰ In the 1990s, however, the Federal Trade Commission launched some challenges against some major vertical mergers, fearing that they would foreclose competition in the upstream and downstream markets. *See, e.g.*, *In re Silicon Graphics, Inc.* 120 F.T.C. 928 (1995) (permitting Silicon Graphics to acquire two developers of graphic software after agreeing to consent order that required interoperability with competitors architecture); *Time Warner-Turner*, 5 Trade Reg. Rep. ¶ 24, 104 (1996) (permitting Time Warner-Turner merger pursuant to a consent order that granted competitors access to broadcast network). The DOJ merger guidelines nonetheless remained unchanged.

¹¹¹ *See Arizona v. Maricopa Co. Med. Soc'y*, 457 U.S. 332, 348 (1981) (holding that "horizontal restraints are generally less defensible than vertical restraints") (citations omitted).

and minimizes transaction costs when compared to institutional alternatives, but an extension to the TCE approach is required.

Institutional Economics and Reputation Mechanisms

The preferred methodology to compare alternative methods of organization, for both TCE and many other schools of institutional economics, is “discrete structural analysis,” which compares the costs and competencies of various governance mechanisms.¹¹² The motivation behind this approach is that alternative organizational forms have different proficiencies and thus present tradeoffs, wherein the superiority of one form over others depends on the attributes of the transaction it is designed to secure. For TCE, this method culminates in the “discriminating alignment” hypothesis, which states that governance structures align with transactions such that transaction costs are minimized.¹¹³ Accordingly, the attributes of both vertical integration and reputation mechanisms can be compared, and an evaluation of how each secures governance while minimizing transaction costs can reveal why New York’s diamond merchants have selected the latter.

TCE explains vertical integration as a mechanism to secure transactions that contract law or market mechanisms cannot assure, but vertical integration imposes countervailing costs and accordingly integration is usefully thought of as a “last resort.”¹¹⁴ Resting on Frederick Hayek’s insights into the benefits of market organization, TCE observes that vertical integration leads to a loss in incentive intensity, whereas market-based organizations maintain acute incentives and enables rapid adaptation to the demands for economic change. Accordingly, TCE

¹¹² See Williamson, *supra* note 95, at 94-105. The method of comparing institutional alternatives goes back to Herbert Simon, who encouraged departing from “highly quantitative analyses” and instead employing “a much more qualitative institutional analysis, in which discrete structural alternatives are compared.” *Id.* (quoting Herbert Simon, *Rationality as Process and as Product of Thought*, 68 AMER. ECON. REV. 5, 6 (1978)).

¹¹³ *Id.* at 46-47.

¹¹⁴ *Id.* at 103.

observes a tradeoff between incentive intensity and transactional security when organizing activity within markets and firms. Assorted “hybrids” that occupy the spectrum between markets and hierarchies reflect the gradual tradeoff, and these intermediate governance mechanisms enjoy greater transactional security than markets yet more incentive intensity than the vertically integrated firm.¹¹⁵

Reputation mechanisms, at first blush, might seem to enjoy both the benefits of markets and the benefits of vertical integration. On one hand, the economic actors who transact in diamond sales are individual merchants who, unencumbered by the bureaucratic costs of vertical integration, feverishly monitor market information and attentively respond to opportunities.¹¹⁶ And on the other, the individual merchants each possess their own reputation, so the reputation mechanism can target and police each individual, thus shaping their future business opportunities and effectively securing the transactions they enter into. However, two features distinguish the diamond dealers’ reputation mechanisms from other governance mechanisms within the traditional TCE framework. The first is that the industry’s agreements are between merchants, and therefore constitute horizontal agreements, whereas TCE classically deals with the vertical relation (and addresses what is classically called “the question of vertical integration”¹¹⁷). The second is the diamond industry’s network is a product of a multilateral agreement, whereas TCE focuses on the individual bilateral transaction.¹¹⁸

¹¹⁵ *Id.* at 104-05.

¹¹⁶ Brokers and agents are often employed for diamond sales, creating some agency costs, but brokerage arrangements are products of contract and do not reflect an integrated employment relationship. Moreover, brokers generally are motivated by commissions and are in steady communication with the owners of the stones they possess, thus these brokerage contracts themselves aim to minimize agency costs. See Richman, *supra* note 5 at 415.

¹¹⁷ Williamson, *supra* note 103 at 6, 82-131.

¹¹⁸ Williamson regularly quotes John R. Commons to have said that “the transaction was held to be the ultimate unit of economic investigation.” *Id.* at 3, citing JOHN R. COMMONS, INSTITUTIONAL ECONOMICS (1934), at 4. One characterization of the firm is as a “nexus of contracts,” *see, e.g.*, Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J.

These departures from the traditional framework require a slight modification to the standard TCE tradeoff between transactional security and incentive intensity. Whereas reputation mechanisms might enjoy both, they also introduce entry barriers. In the diamond industry, for example, only those who have already established a strong track record can credibly commit to fulfilling their contractual obligations for a credit sale, and so a good reputation is a prerequisite to entering into and succeeding in the industry.¹¹⁹ Consequently, an industry that relies on reputations necessarily creates entry barriers and thus fails to capture the innovations and dynamism that new entrants typically introduce. For these reasons, reputation mechanisms suffer from significant dynamic inefficiencies, and economic history has shown that enforcement mechanisms that employ reputational sanctions and support personal exchange have been replaced by instruments that enable impersonal exchange, such as state-sponsored courts.¹²⁰ Moreover, the World Bank and other authorities on development equate personal exchange with crony capitalism and associate a nation's economic growth with the effectiveness of its public contractual enforcement.

POL. ECON. 101 (1980), but even this perspective views the “contracts” as a series of vertical relationships stemming from a principal.

¹¹⁹ Good reputations can be bequeathed, and so the diamond industry has remained vibrant by allowing generations of entry by family members. Ethnic identity can also serve as a credible assurance of trustworthiness, and members of a close-knit community can also enter. These family and community institutions not only explain the homogeneous composition of today's diamond market, but they also how community institutions can bestow a competitive advantage for members over nonmembers. See Richman, *supra* note 5.

¹²⁰ See AVNER GRIEF, INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE (2006); Avner Grief, *The Birth of Impersonal Exchange: The Community Responsibility System and Impartial Justice*, 20 J. ECON. PERSP. 221 (2006). Systems of personal exchange that rely on familiarity also face size constraints, since there are limits to the number of individuals merchants can be familiar with and trust. Some systems of personal exchange failed to compete with impersonal exchange because they could not grow fast enough, others failed because they grew beyond their capacities. See GRIEF, INSTITUTIONS, at Chapter 6; Grief, *Impersonal Exchange*, at 231.

Introducing entry barriers into the standard tradeoff between transactional security and incentive intensity yields the comparative institutional analysis reflected in Table 1.¹²¹ The table suggests that both vertical integration and reputation mechanisms arise to replace market transactions supported by state-sponsored courts when public courts offer inadequate transactional security. More important, the table posits that reputation mechanisms are to vertical integration when the costs of erecting entry barriers are lower than the costs of diluting incentives from vertical integration.

TABLE 1—INSTITUTIONAL ALTERNATIVES AND ASSOCIATED ATTRIBUTES

	Public Courts, Arms-Length Exchange	Private Ordering, Reputation Mechanisms	Vertically Integrated Firm
Transactional Security; Low-Cost Enforcement	-	+	+
Allows Entry	+	-	+
High-Powered Incentives	+	+	-

The diamond industry is clearly a setting in which the gains from maintaining high-powered incentives outweigh the costs of entry barriers. Adding value to a particular diamond is largely dependent on collecting market information, exposure to market pressures, and the capacity for spontaneous adaptation. This is a consequence of the heterogeneity of diamonds, with each stone presenting tacit qualities that creates significant variation in the willingness-to-pay of ultimate buyers. Heterogeneous

¹²¹ For a broader comparative institutional analysis, as well as a discussion of how this model fits into the separate literatures on private ordering and transaction cost economics, see Richman, *supra* note 55.

valuation means that finding an optimal buyer for a specific stone is a very profitable enterprise, and thus diamond merchants use market information to search for the optimal buyer for each stone and to purchase stones for arbitrage. This matching process—the search for the “right” buyer—requires sellers and brokers to gather market information regarding buyer demand and pair their idiosyncratic needs with the distinct qualities of available stones.¹²² In this respect, the DDC is purely a commodities exchange, and like other exchanges, it assembles individual traders in a central facility where market information is gathered, sellers are matched with buyers, and high-powered incentives reign. The trading floor of the Diamond Dealers Club further resembles exchange houses, including one located farther south in Manhattan, with its fervor, zeal, and swirl of high-powered incentives. More generally, the DDC and the organizational structure of New York’s diamond merchants is a common template for exchange houses of all kinds, where merchants and market information are assembled to facilitate an optimal matching process.

Meanwhile, and unlike most areas of commerce, entry barriers do not severely hinder the diamond industry.¹²³ The numbers of merchants in various diamond centers approach levels where collusion or coordination would be difficult, even with the assorted community connections that members share (the New York Diamond Dealers Club, for example, is home to two thousand members). Moreover, technological innovation has

¹²² The matching process is somewhat complicated by a buyer’s need to examine a diamond personally and carefully in order to arrive at a personal valuation, so executing sales requires bringing diamonds to a prospective buyer for inspection. This is another reason why the diamond industry relies on a central trading area. However, as sales have globalized, and even as some merchants have managed to use the internet to execute sales, in-person inspection is still highly preferred. Accordingly, the industry has expanded by creating more diamond bourses.

¹²³ Although entry is essentially impossible for most individuals, it should be noted that the industry does appear to permit entry to groups who can credibly sustain the industry’s reputation mechanism. Indian merchants who are Palanpuri Jain, an insular sect with a history of cutting diamonds and other gemstones, have managed to acquire approximately 10% of New York’s diamond market. This does not minimize the severity of the industry’s entry barriers, but it does indicate that membership to a group where community institutions can facilitate collective sanctions offers a competitive advantage over generic entrants. *See* Richman, *supra* note 5 at 410-11.

played a relatively small role in the industry's history. The process of selling a diamond has always required in-person inspection and sales, and thus the matching process cannot benefit from economies of scale.¹²⁴ More importantly, even though there are entry barriers along the industry's system of wholesale distribution, where reputation mechanisms discipline conduct at the DDC, other distribution channels are available to lead the diamond's path from mine to jewelry manufacturer. Other bourses compete with the DDC, and attempts by internet marketers have tried to forge alternative distribution systems. Additionally, entry is not entirely foreclosed, and the industry has witnessed entry by ethnic groups who have been able to adopt and sustain the industry's reputation mechanisms.¹²⁵ But perhaps the greatest indication that entry barriers have not been costly has been the continued dominance—over several centuries—of Jewish and ethnic networks over the distribution system.¹²⁶ Only the boldest conspiracy theorist would suggest that entry barriers could secure a stranglehold over an industry for nearly one millennia and through the associated technological innovations, historical upheaval, and political change. The survival of those networks is more likely a function of their superiority over, not their insulation from, market challengers.

In sum, a comparative institutional analysis, which examines the alternative mechanisms with which the diamond industry could secure contracts between its merchants, suggests that concerted group boycotts is the mechanism that most efficiently meets the industry's demands for transactional security. Were antitrust to consider institutional efficiencies, it would consider the diamond merchants' multilateral enforcement system to

¹²⁴ There are certain efforts to codify and categorize stones so their values are known without inspection. For example, certification and grading by the Gemological Institute of America (GIA) and other grading organizations can suggest a stone's value, but these processes still leave room for substantial variation, forcing buyers to continue resorting to in-person purchases. See Russell Shor, *Diamond Grading Reports: Flawless or Imperfect?*, JEWELERS' CIRCULAR KEYSTONE, July 1995, available at <http://www.gemology.ru/cut/english/diamgrad.htm> (noting that "[i]t's no trade secret that diamonds can get different grading reports or 'certificates' from different labs—or even the same lab").

¹²⁵ See *supra* note 123.

¹²⁶ See Richman, *supra* note 5, at 385-89.

be an effort to secure transactions while minimizing transaction costs. Consequently, if the rule of reason were applied, it would be deemed to be a procompetitive collaboration rather than an instance of anticompetitive collusion, and therefore it would not violate the Sherman Act. More generally, this institutional analysis reveals systematic procompetitive features of concerted refusals to deal. A tradeoffs analysis confirms that reputation mechanisms impose entry barriers and can target rivals that deviate from the majority, but it also reveals that reputation mechanisms can enforce contracts at low transaction costs and can support certain trade that alternative mechanisms cannot. Accordingly, antitrust treatment of group boycotts should continue to move away from the *per se* rule and should regularly consider whether particular boycotts are superior solutions to difficult transactional challenges.

Extensions: Additional Applications of Institutional Economics & Antitrust

Applying institutional economics to horizontal agreements, such as the collaboration that creates the enforcement system for New York's diamond merchants, continues a story that began several decades ago, when institutional economics started influencing antitrust policy towards vertical restraints. But the story should persist, since institutional economics has more to say on antitrust policy for horizontal restraints, beyond its criticism of the *per se* rule against boycotts.

For example, the analysis of the DDC suggests more generally that antitrust should approach multilateral collaborations with market power with more leniency. In *Northwest Wholesale Stationer*, which applied the Sherman Act to a purchasing cooperative that expelled one of its members, the Court ruled that the cooperative was not subject to the *per se* rule and thus remanded to the appellate court a review of the district court's rule of reason analysis.¹²⁷ However, even as the Court limited the applicability of the *per se* rule, it noted that the rule still applied to cooperatives with market

¹²⁷ 472 U.S. 284, 297-98 (1985).

power or exclusive access to an element that is essential to compete.¹²⁸ The DDC might very well fall into this category – its merchants control nearly all of the national diamond market, it is the gateway to essential market information, and membership is a necessary credential to compete. Nonetheless, it is a collaboration that is necessitated by the transactional difficulties in diamond sales.

Another doctrine on horizontal restraints that institutional economics might influence is the reliance on what might be called the “essential” requirement. The Supreme Court has carved out an exception to the *per se* rule that applies to collaborations that “are essential if the product is to be available at all.”¹²⁹ In *NCAA*, the Court ruled that *per se* treatment of restraints that governed teams in an athletic league was inappropriate because such restraints were essential to offer the marketed product.¹³⁰ This same approach was employed in the Tenth Circuit’s ruling in *SCFC v. Visa*, which ruled that the collaboration of banks that offer Visa credit cards were not obligated to include a financial institution that also offered a competing credit card.¹³¹ Perhaps this principle should be pushed farther, beyond collaborations that are essential to offer a product. The DDC and its reputation mechanism, for example, are not essential to support diamond trade, but they are efficient arrangements of distribution. An examination of institutional efficiency, rather than necessity, might offer a reason for an even narrower application of the *per se* rule.

Part of the motivation behind the “essential” requirement is some confusion behind what underlies the ownership structure of certain industries. Part of the justification behind joint ventures deemed to be

¹²⁸ *Id.* at 298 (“A Plaintiff seeking application of the *per se* rule must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects ... [S]ome showing must be made that the cooperative possess market power or unique access to a business element necessary for effective competition.”)

¹²⁹ *Nat’l Collegiate Athletic Assoc. v. Regents of Univ. of Oklahoma*, 468 U.S. 85, 101 (1984).

¹³⁰ *Id.* at 117 (“[A] certain degree of cooperation is necessary if the type of competition that petitioner and its member institutions seek to market is to be preserved.”)

¹³¹ 36 F.3d 958 (10th Cir. 1994).

necessary to support a product is the presumption that an ownership is exogenous. Areeda & Hovenkamp, for example, conclude:

In sum, then, joint ventures are artificial devices that represent an efficient method of engaging in enterprise given a particular set of assumptions about ownership. The relevant antitrust policy questions focus not on whether alternatives to the venture are theoretically possible, but on whether the existing venture restrains competition unnecessarily, given the ownership arrangements that already exist.¹³²

However, institutional economics teaches precisely the opposite, that ownership arrangements are maximizing responses to transaction costs and other market forces. Therefore, ownership structure should not constrain the antitrust analysis, rather, it should inform the analysis. For sports leagues, for example, antitrust policy should examine why most leagues are joint ventures of independently owned teams, rather than divisions of a single entity. Approaching these ownership allocations as efforts to economize would inform the antitrust scrutiny of the subsequent collaboration.

In sum, antitrust law does not have an explicit recognition of institutional efficiencies when it evaluates horizontal restraints, but institutional economics, and specifically TCE, has much to offer. These institutional approaches suggest that certain collusion between competitors reflect procompetitive efforts to minimize transaction costs, such as securing transactions while maintaining the power of market incentives. To the degree that current antitrust law views collaborations sympathetically, it usually demands an efficiency justification for collaborations, with an emphasis on efficiencies motivated by price theory (such as standard setting or network externalities).¹³³ But there is room for institutional analysis, both in limiting the *per se* rule and in conducting a rule of reason analysis.

¹³² 13 AREEDA & HOVENKAMP, ¶2220 at 292.

¹³³ See, e.g., ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS, Fed. Trade Commission & U.S. Dep't of Justice, April 2000. Available at: <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>

IV. ANTITRUST ENFORCEMENT AND DIAMOND DEALERS: PRELIMINARY EMPIRICS

If Section II convincingly argues that the collective conduct of New York's diamond dealers and the facilitating role of the DDC are in tension with current antitrust law, it is not surprising that New York's diamond merchants have a history of receiving antitrust scrutiny.¹³⁴ It is surprising, however, that this history is a rather modest one. Although too much should not be read into the handful of antitrust actions that were brought against the DDC and the industry's leaders, the most notable consequence of this history is that, despite the several actions and several decades of collusive conduct, the merchants' underlying activity has remained unchanged. The few cases that have been brought were either settled or dismissed, and even though the cases familiarized antitrust policymakers with the diamond industry's capacity and propensity to execute group boycotts, both the courts and antitrust policymakers were unwilling to impose structural change onto the industry's system of self-policing.

United States v. Diamond Center, Inc. (S.D.N.Y. 1952)

In 1942, two years after the Nazi invasion of Belgium devastated Antwerp's diamond industry, confiscating its remaining assets and sending its many Jewish dealers to concentration camps, the New York Diamond Dealers' Club passed a resolution that prohibited admission to all individuals who were deemed to be associated with Nazi organizations and

¹³⁴ The diamond dealers' collusive activity is distinct from DeBeers' conduct atop the diamond distribution chain, which has invited many run-ins with the U.S. antitrust laws. South Africa-based DeBeers' first confrontation with U.S. antitrust policymakers was in 1945, when the Department of Justice sued it under Section 2 after DeBeers refused to sell industrial diamonds for the U.S. war effort. The suit ultimately forced DeBeers to remove all contact with the U.S. market, and DeBeers did not challenge subsequent suits brought by the DOJ in 1957, 1974, and 1994. In 2004, DeBeers requested to settle the outstanding charges from the 1994 suit, pled guilty to price fixing and paid a \$10 million fine. The settlement enabled DeBeers officers to enter the United States without fearing arrest for the first time since 1945. See *DeBeers to Pay \$10 Million Fine, Ending Price-Fixing Lawsuit*, WALL ST. J., Jul. 14, 2004; *DeBeers Agrees to Guilty Plea to Re-enter the U.S. Market*, NEW YORK TIMES, Jul.10, 2004.

business interests.¹³⁵ In 1949, when more than 80% of DDC members were refugees or family of victims from the Lowlands of Europe,¹³⁶ the DDC passed a more sweeping resolution:

The Board of Directors condemns the action of any member, who manufactures either directly in Germany or who deals in German goods. The names of said members, who are found guilty of manufacturing or dealing in or with Germany or German goods will be posted on the bulletin board and displayed in a conspicuous place in the clubrooms.¹³⁷

On June 23, 1952, the Department of Justice's Antitrust Division filed a complaint against the Diamond Dealers' Club for "engag[ing] in an unlawful combination and conspiracy to restrict and prevent the importation of diamonds from and the exportation of diamonds to Germany."¹³⁸ The complaint alleged that the association and its members agreed that "no member shall deal, directly or indirectly, with any member of the German diamond industry or its services or products [and] that each defendant shall take steps to expel from its membership or otherwise discipline any dealer

¹³⁵ C.138-285 (S.D.N.Y. 1953), transcript at 7.

¹³⁶ *Id.*

¹³⁷ Civil Action No. 76-343 (S.D.N.Y. 1952), Interrogatory to DDC, at 14. This resolution followed a similar resolution at an international gathering of diamond dealers, and it was implemented by a "German Activities Investigation Committee" which was formed jointly with The Diamond Center and was assigned the responsibility of carrying out the resolutions in cooperation with like-minded international associations. *See* C.138-285 (S.D.N.Y. 1953), transcript at 4.

¹³⁸ Civil Action No. 76-343 (S.D.N.Y. 1952), complaint, at 4. Also listed as a defendant was the Diamond Center, Inc., which was described with the DDC as "trade associations whose members are dealers in diamonds." The Complaint lists the members of both associations (1500 in the DDC, 900 in the Diamond Center), as well as the umbrella organization World Federation of Diamond Bourses, as co-conspirators, *id.* at 2-3. The Complaint also notes that "Membership in either club is essential to the business of dealing in diamonds since all trading is done in the meeting rooms of the two associations.... Suspension or expulsion from either association results in suspension or expulsion from all associations which are members of the World Federation." The DDC's answer to the complaint notes that the correct membership figures are 1,424 and 916, respectively, of whom 557 individuals are members of both associations.

violating the terms of the agreement.”¹³⁹ In short, the DDC was sued for orchestrating a concerted group boycott.

The DDC, along with co-defendant The Diamond Center, Inc. (a smaller New York diamond bourse), asserted as an affirmative defense that the Club’s

opposition to dealing in products of the German diamond industry is an expression of its members’ horror and indignation, on broad moral grounds, at intercourse with a nation and with individuals guilty of waging aggressive war, of genocide, and of murder, rape, arson, robbery and similar crimes. Over 99% of [the DDC’s] members are Jews who themselves, or whose friends, families, and associates, were particular victims of the criminal policies pursued by Germany and by Germans.¹⁴⁰

In 1953, after vigorous negotiations with antitrust policymakers in Washington and New York, the DDC changed its not-guilty plea to a plea of *nolo contendere* and pledged to cooperate with antitrust enforcers, including adopting a provision in the DDC by-laws that prohibited all restraints of trade.¹⁴¹ In accepting the DDC’s plea, the Court imposed the nominal fine of \$250.¹⁴²

¹³⁹ *Id.* at 5.

¹⁴⁰ Civil Action No. 76-343 (S.D.N.Y. 1952), Answer of Defendant Diamond Dealers Club, Inc, at 2. The DDC also argued that the boycott of German goods and merchants had no material economic impact, and that it further was political expression that was protected under the First Amendment. *Id.*

¹⁴¹ *See supra* note 39.

¹⁴² Docket #58,516, No. C 13/285, filed Oct.15, 1953 (S.D.N.Y.). Judge Gregory F. Noonan, who presided over the parallel suit against The Diamond Center, which was also assessed the nominal fine of \$250, pointedly stated in his ruling from the bench:

In this country we try to forget the past and to forgive. You cannot permit a cancerous growth to commence and grow in this country which will revive and revivify and continue the ancient feuds and hatreds which these people have in their hearts quite justly and which they brought with them from abroad when they first came to our shores.... I can understand the feeling of these people one thousand per cent. If I had been a member of the association, I probably would have voted for the resolution. On the other hand, as I see these people being sworn in as new citizens every time that I administer

The ruling was viewed as a personal victory for the DDC. At the sentencing hearing, the DDC attorney explained that the resolution was motivated “purely on a moral and religious ground” and took pains to detail the dealers’ motivation in passing the resolution:

They saw the Germans come in 1914, saw their families wiped out, and to a certain extent that is what happened in 1940. They saw not only their money gone but their property gone, and some of our members saw their entire families completely killed in front of their eyes.... We now place ourselves at your mercy, your Honor. We would like an indication to our people that we have done the right thing.¹⁴³

These words gave the dealers a sense of vindication. As one subsequent Chairman of the DDC put it many years later:

Despite that plea [of *nolo contendere*], the Diamond Dealers Club did not want the terrible facts, which precipitated its actions, to go unrecited. At the sentencing, Nathan Math [the DDC attorney] eloquently defended the Club and the action of its members, bringing forth all the pain suffered at the hands of the Nazis. When he had finished, he had accomplished his purpose. The two clubs were fined \$250, [b]ut the words of Nathan Math, and their impact on those who heard him, gave the Club the victory it sought.¹⁴⁴

Even if both the DDC and the DOJ felt justified in claiming victory, the events’ legal significance is thin, and the dispute might be written off as nothing more than a misunderstanding. The court record suggests that the DDC had received assurances that their boycott did not run afoul with US

the oath, they have to try to get out of their minds – while it is proper to keep with them the spiritual values that they brought with them when they came from a foreign country, yet they have to try to make up their minds that they are going to put behind them all those things they hoped they were leaving behind when they left the shores of the foreign country.

Transcript at 10, 12. The defendants assured the court that they would forgive, though did not pledge to forget.

¹⁴³ C 138-285, filed Oct. 13, 1953 (S.D.N.Y.), Transcript at 7, 12.

¹⁴⁴ ALBERT J. LUBIN, *DIAMOND DEALERS CLUB: A FIFTY-YEAR HISTORY* (1982), at 15.

law, and the Justice Department and the presiding judges seemed to discount the DDC's actions as forgivable conduct by recent immigrants who were unfamiliar with American culture and rules.¹⁴⁵ Nonetheless, it is revealing that neither the Department of Justice nor the Court expressed much alarm over the DDC's system of self-policing, particularly given its power to exclude merchants of a particular nationality. In accepting the DDC's pledge to cease its boycott against German entities, antitrust policymakers were unconcerned that the diamond dealers could collude to exclude other merchants or to impose anticompetitive restraints on the national industry, and the Department of Justice has never again initiated another action against New York's diamond dealers.¹⁴⁶

Rapaport v. DDC (N.Y.S. 1983)

On December 9, 1981, "counselors for unnamed diamond dealers" petitioned the Federal Trade Commission to investigate the business conduct of the Rapaport Diamond Corporation.¹⁴⁷ The complaint alleged that Martin Rapaport, who was both a broker of diamonds and also a publisher of a weekly newsletter that listed market prices of wholesale diamonds, was "artificially fixing prices in the diamond industry by disseminating an unsubstantiated price report."¹⁴⁸ This complaint marked the beginning of a long and colorful legal battle between Martin Rappaport and his DDC colleagues.

Martin Rapaport was a successful and ambitious diamond dealer who started publishing in 1978 the *Rapaport Prices List*, a weekly newsletter that published the prices of diamonds of assorted carats and cuts that were sold in the DDC during the preceding week. The newsletter, which soon grew into the *Rapaport Diamond Report* that covers all matters of interest to the diamond industry, brought much-desired transparency to

¹⁴⁵ *Id.* at 12, 15.

¹⁴⁶ The DOJ has, however, initiated many antitrust suits against DeBeers, see *supra* note 134.

¹⁴⁷ FTC Staff Request for DOJ Clearance, Fed. Trade Commission Archives, matter #821-0041.

¹⁴⁸ *Id.*

diamond market prices, and though subscriptions spread throughout DDC members and the entire diamond industry, many dealers complained that prices quoted in the *Report* were frustratingly low.¹⁴⁹ Certain prominent DDC members mounted opposition to Rapaport's growing influence within New York's diamond circles, complaining both that the *Report* generated more benefit to Rapaport than to his subscribers (or to the market) and that Rapaport was bringing instability to a market and merchant community that craved order and self-control. Rapaport, embracing his label as an industry "Maverick," coolly responded that the dealers were struggling to adapt to shrinking margins and more competition.¹⁵⁰ Tension between Rapaport and many of the DDC's elders and spilled into the broader Jewish community, with a Jewish religious court ordering Rapaport to stop publishing his pricelist (threatening excommunication) and Rapaport getting death threats, including one telephoned from a matzah factory in Brooklyn.¹⁵¹

The first shot was fired by the "unnamed diamond dealers" in the form of the complaint to the FTC, which was promptly referred to the Commission's horizontal restraints program.¹⁵² The FTC staff launched an initial phase investigation but found no evidence of any conspiracy to manipulate diamond prices, and it closed the investigation on June 7, 1982.¹⁵³ The dispute reached a "boiling point"¹⁵⁴ that same month when Rapaport made highly critical comments in an industry magazine article about diamond investment firms, many of which were run by prominent

¹⁴⁹ Rapaport v. Diamond Dealers Club, Inc., 1983 WL 14942 (N.Y. Sup. 1983), at *1.

¹⁵⁰ Sandra Salmans, *A Diamond Maverick's War with the Club on 47th Street*, NEW YORK TIMES, Nov. 13, 1984, at A1.

¹⁵¹ *Id.*

¹⁵² Matter Initiation Notice, Dec. 9, 1981, Fed. Trade Commission Archives, matter #821-0041.

¹⁵³ June 1, 1982 memorandum, Fed. Trade Commission Archives, matter #821-0041. The staff investigation noted that "because there seemed to be a question as to the accuracy of some of the prices reported," and thus a possibility that Rappaport was using false reporting in his newsletter to manipulate wholesale diamond prices to benefit his own diamond sales, the FTC memo reported that Rappaport's conduct would be better scrutinized under Section 2, for possible attempts to monopolize the market, but it nonetheless concluded that the wholesale market was very unlikely to be monopolized by Rappaport or by any other dealer. *Id.*

¹⁵⁴ *Id.*

DDC members.¹⁵⁵ Invoking a provision in the by-laws authorizing the DDC Board of Directors to expel any member for making “any statement, act, or conduct which in the Board’s sole judgment and discretion reflects adversely upon the integrity of any member or of the Organization,”¹⁵⁶ the DDC Board voted to expel Rapaport. Rapaport promptly sued the DDC in New York state court, demanding readmission to the DDC and bringing a damage action for \$55 million.¹⁵⁷

The DDC actions against Rapaport once again invited the scrutiny of the FTC, but this time the Commission’s attention was directed at the exclusionary conduct of the DDC. In February of 1984, the FTC Commissioners authorized an investigation whether the DDC or its members “may have entered into agreements to unreasonably restrain trade or commerce by obstructing the collection and dissemination of information concerning current diamond prices.”¹⁵⁸ Subpoenas were issued to DDC officers and other prominent figures in New York’s diamond industry—which the DDC, claiming the dispute with Rapaport was a private matter, throughout the proceedings—and the Commissioners authorized a full-scale investigation.¹⁵⁹

The entire matter settled in early 1986, with Rapaport being readmitted to the DDC, his full standing in New York’s diamond community was secured, and the DDC Board and members took no

¹⁵⁵ Rapaport v. Diamond Dealers Club, Inc., 1983 WL 14942 (N.Y. Sup. 1983), at *1. Rapaport reportedly said, “diamonds, ethics, Feh! If the devil himself showed up they would sell to him.” Bernstein, *supra* note 5 at 139, n.50.

¹⁵⁶ DDC By-Laws, Art.VII, Sect.2. Although the language of the by-laws appear to give arbitrary power to the Board, the primacy of a merchant’s reputation is a good justification for empowering the Board to punish those who impugn the character of a particular merchant. The protection of individual reputations, and the judiciousness of revealing accurate reputation information, is an important feature of the industry’s reputation mechanism. See Richman, *supra* note 5, at 401-02.

¹⁵⁷ *A Diamond Maverick*, *supra* note 150.

¹⁵⁸ FTC Archives, Secretary’s Matters, Open Meeting of the FTC, Tuesday, Sept. 18, 1984.

¹⁵⁹ *Id.* In perhaps an illustration of the bitterness of the dispute, lawyers for the DDC moved to quash the subpoenas and petitioned to recuse Commissioner Calvani, who authorized the subpoenas, from the proceedings. Both motions were denied. The DDC was far more accommodating to the DOJ’s investigation three decades earlier.

additional actions to disrupt the dissemination of the *Rapaport Diamond Report*. Rapaport and his *Report* have since flourished in New York's diamond community, and later in 1986, Rapaport was even elected as a DDC director.¹⁶⁰ Lisa Bernstein concludes from the incident that “the norms of the diamond industry only work when they capture information that the market values,” and that the DDC's failure to expel Rappaport is attributed to the value generated by his *Report*.¹⁶¹ A more modest conclusion is that the FTC and the New York State Court declined to intervene in what they viewed as an internal dispute even though both clearly observed the potential dangers of the industry's self-policing regime. The affair illustrates how personal animus and differing business philosophies could motivate the DDC's system of exclusion and collective boycotts to turn against an innocent and entrepreneurial “maverick.” It is not surprising that such a dispute attracted the attention of federal antitrust enforcers, but it is at least slightly surprising that those enforcers were eager to disengage when the dispute at hand was settled.¹⁶²

Results from a Westlaw Search

The Department of Justice's action in the 1950s and Rapaport's suit in the 1980s are the two highlights in the DDC's history of antitrust actions, with the latter receiving substantial attention both throughout the industry and in the popular media. Aside from those two, however, the history is bare, and the antitrust laws have not been invoked in any judicial decision against the New York Diamond Dealer's Club. A Westlaw search in all state and federal courts from 1945 through 2006 for any cases that mentioned “Diamond Dealers Club” yielded only thirty-five cases results (including some duplicates),¹⁶³ with only Rapaport's 1983 suit involving an

¹⁶⁰ Crain NY Business, June 23, 1986.

¹⁶¹ See Bernstein, *supra* note 5, at 139, n.50.

¹⁶² Rapaport continues to popularize innovative business practices and continues to attract criticism from industry interests. See <http://jck.polygon.net/archives/1998/07/jc078-105.html>

¹⁶³ See Appendix A.

antitrust claim.¹⁶⁴ This is not because expulsions from the Club are infrequent – there are several each year – but instead must be a consequence of expulsions failing to invite legal intercession. This search does not reveal how many antitrust suits are initiated, only the cases that generate judicial opinions, but cases that settle and do not otherwise invite judicial intervention suggest that courts remain deferential to the DDC’s rules and its self-policing.

Judicial deference to DDC self-policing is more evident in the many cases where New York state courts uphold DDC arbitration rules, including a finding that a father is liable for his son’s debts,¹⁶⁵ an award that included a surcharge above and beyond what would be recoverable in state court,¹⁶⁶ and an award handed down by a DDC arbitrator despite his having shown bias against one party.¹⁶⁷ This deference to industry arbitration is consistent with deference shown to other industry arbitrators. To investigate whether the DDC’s absence from antitrust actions was unique, a similar Westlaw search was conducted for cases involving an assortment of other trade associations that, like the DDC, create industry rules that govern transactions and mandate private industry-sponsored arbitration for all disputes: the Memphis Cotton Exchange, the American Cotton Shippers’ Association, the American Textile Manufacturers Institute, and the National Grain and Feed Association.¹⁶⁸ Lisa Bernstein has further observed that these trade associations rely on non-legal sanctions to help enforce

¹⁶⁴ Even Rapaport’s antitrust claim was grouped with six other claims, all of which were nestled within a 144-page, 219-paragraph, 35-exhibit complaint that the court found “prolix, confusing, and difficult to answer.” *Rapaport v. Diamond Dealers Club, Inc.* 95 A.D. 2d 743, 744 (N.Y.S. 1983).

¹⁶⁵ *Siegelson v Krischer*, NY Supreme Ct, App Div, 668 N.Y.S.2d 20 (1998)

¹⁶⁶ *Israel Discount Bank Limited v Rosen*, NY Supreme Ct, App Div 565 N.Y.S.2d 29 (1991).

¹⁶⁷ *Namdar v. Mirzoeff*, NY Supreme Ct, App Div 555 N.Y.S.2d 101 (1990) (upholding arbitration award despite evidence of arbitrator’s bias because bias was known before proceeding but was not raised). *But see* *Rabinowitz v. Olewski*, NY Supreme Ct, App Div. 473 N.Y.S.2d 232 (1984) (affirming a lower court’s replacing a DDC arbitrator with a neutral arbitrator, after ruling that the DDC’s arbitrators would irreversibly bias against a party linked to connections with the PLO).

¹⁶⁸ See Appendix B.

executory contracts, similar to how Jewish community institutions help police New York's diamond dealers.¹⁶⁹ This Westlaw search, which searched for all cases in which any of the above trade associations were a named party, found only four results that contain any mention of antitrust law and only one case that contained a substantive antitrust claim (which never reached a judicial resolution).¹⁷⁰

One interpretation of this barren record is that the analysis in Part II is inaccurate, and that trade associations that self-police executory contracts through concerted boycotts present few conflicts with U.S. antitrust law. The few cases that have been brought, however, suggest that the antitrust laws have not gone unnoticed, particularly by the policymakers who have scrutinized the conduct of New York's diamond dealers. A better interpretation of the short history, particularly given the few actions that have been brought, is that antitrust policymakers have noticed and confronted the dealers' system of collusive self-policing and have decided to leave the industry's structure unchanged.¹⁷¹

CONCLUSION

Even as reputation mechanisms are a fixture in the economy and remain a topic of fascination among academics, they present the danger of running afoul with the antitrust laws. This article recognizes that beneficial reputation mechanisms can be characterized as horizontal agreements to implement group boycotts, that these agreements are literal violations of current antitrust law, and that antitrust law therefore requires reform. This is because antitrust has not explicitly recognized the institutional

¹⁶⁹ See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Value Creation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001); *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms* 144 U. PENN. L. REV. 1765 (1996).

¹⁷⁰ *Bolin Farms v ACSA*, 370 F.Supp. 1353 (W.D. La. 1974).

¹⁷¹ Perhaps there is a parallel between the deference courts show when adjudicating antitrust these claims and the deference shown when asked to intervene in relational contracts. In both instances, courts might recognize the merits to deferring to systems of self-enforcement. For self-enforcing contracts, see Robert E. Scott, *A Theory of Self-Enforcing Indefinite Contracts*, 103 COLUM. L. REV. 1641 (2003).

efficiencies of horizontal agreements that arise in response to what is best described as a court failure. Transaction cost economics offers a procompetitive justification for those horizontal restraints and suggests that antitrust law should be more receptive to certain concerted refusals to deal. Reputation mechanisms and their corresponding group boycotts can be procompetitive joint ventures to manage a competitive industry, and therefore should be permissible under antitrust laws that are dedicated to maximizing consumer surplus.

The most immediate implication for antitrust law is that it should not apply the *per se* rule to concerted group boycotts since many of these might support procompetitive reputation mechanisms. But a broader consultation of institutional economics might yield many more lessons for antitrust law as well. Institutional economics should be useful, for example, in helping antitrust policymakers distinguish anticompetitive group boycotts from procompetitive joint ventures to establish collaborative enforcement mechanisms. More generally, antitrust analysis of industry self-policing and trade associations should include an appreciation for transaction costs, organizational efficiencies, and the comparative strengths of alternative institutional arrangements. Even if an antitrust analysis of a small segment of an unusually structured industry suggests a relatively minor reform to antitrust law, it implies that new methodologies could inform a larger category of antitrust analysis.

APPENDIX A – WESTLAW SEARCH FOR DDC CASES^o

Case Name	Date	Court & Citation	Relevant Facts & Outcome
Application of Gray	11/3/1958	N.Y. Sup. Ct. 181 N.Y.S.2d 538	DDC member Gray purchased diamonds from insolvent merchant, whose creditors tried to force Gray into DDC arbitration. Court ruled member cannot be forced into DDC arbitration by non-members.
Langer v. Liverant	6/13/1963	N.Y. App. Div. 240 N.Y.S.2d 660	Suspended DDC member tried to invoke club's mandatory arbitration clause; court found that a suspended member may not compel arbitration under DDC by-laws.
Verstandig v. DDC	2/4/1965	N.Y. App. Div. 256 N.Y.S.2d 318	Court affirmed unpublished trial judgment which upheld DDC suspension of Verstandig for breach of Debtor-Creditor General Rules of the Club.
Verstandig v. DDC	07/09/1965	N.Y. 16 N.Y.2d 483	Motion for leave to appeal denied.
Siegman v. Orion Ins. Co.	4/2/1971	Cal. Ct. App. 94 Cal.Rptr. 80	DDC member provided "c/o DDC office" address on insurance policy for separate office location, which was later robbed. Dispute over whether robbery of separate office location was "inside" or "outside" insured premises. Court determined "premises" to be where plaintiff regularly conducted business.
Lipschutz v. Gordon Jewelry Corp	2/22/1974	S.D. Tex. 373 F.Supp. 375	DDC members offered evidence in dispute over which law to apply in order to interpret insurance policy.
Schachter v. Kohn	5/20/1975	N.Y. App. Div. 371 N.Y.S.2d 626	Award without opinion to Kohn and DDC.
Leon Finker, Inc. v. Schluskel	5/2/1979	S.D.N.Y. 469 F.Supp. 674	DDC arbitrators refused to arbitrate trademark dispute between DDC members; no ass'n policies involved.
Rapaport v. DDC	2/23/1983	N.Y. Sup. Ct. 1983 WL 14942	DDC expelled Rapaport, Rapaport sued for readmission and for damages, partly under N.Y. antitrust law. Court issued preliminary injunction to reinstate

^o All cases in bold include mentions of "antitrust" "restraint of trade" or "Sherman Act."

			Rapaport as DDC member.
In re Mastrangelo	5/13/1983	Bankr. D. Mass. 34 B.R. 399	DDC member involved in bankruptcy proceeding; no ass'n policies involved.
Rapaport v. DDC	6/28/1983	N.Y. App. Div. 464 N.Y.S.2d 180	Appeal of prelim. injunction rendered moot, permission to amend complaint.
Biller v. Felsenberg	11/23/1983	N.Y. 60 N.Y.2d 559	Motion for leave to appeal unpublished case dismissed without opinion.
Biller v. Felsenberg	11/23/1983	N.Y. 60 N.Y.2d 924	Motion for leave to appeal unpublished case dismissed on ground of movant's death.
Biller v. Felsenberg	11/23/1983	N.Y. 61 N.Y.2d 606	Motion for leave to appeal unpublished case dismissed without opinion.
Rabinowitz v. Olewski	3/12/1984	N.Y. App. Div. 473 N.Y.S.2d 232	DDC member sued to avoid DDC arbitration, fearing discrimination after letter circulated suggesting member's links to the PLO and crime. Court disqualified DDC arbitrators for bias, replacing DDC arbitrator with an independent arbitrator.
Goldfinger v. Lisker	1/14/1986	N.Y. 67 N.Y.2d 601	Motion for leave to appeal granted.
Goldfinger v. Lisker	10/21/1986	N.Y. 68 N.Y.2d 225	DDC member sued to disqualify arbitration ruling since arbitrator had private communication with one litigant. Court held private communication was misconduct sufficient to vacate arbitration award.
Etu v. Cumberland Farms	3/9/1989	N.Y. App. Div. 538 N.Y.S.2d 657	Rapaport v. DDC cited in product liability case; no ass'n policies involved.
I. Kasziner Diamonds v. Zohar Creations	3/23/1989 (amended)	N.Y. App. Div. 536 N.Y.S.2d 449	Plaintiff delivered diamonds to defendant's employee; diamonds were later lost. DDC by-laws state agent is personally liable. Court refused to hold agent personally liable for loss.
Rose v. Giamatti	6/13/1989	Ohio Com. Pl. 1989 WL 111445	Brief case cited Rabinowitz (above) regarding arbitration law.
Rose v. Giamatti	6/28/1989	Ohio Com. Pl. 1989 WL 111454	Brief case cited Rabinowitz (above) on point of arbitration law.
Bomash v. Friedman	10/2/1989	N.Y. App. Div. 546 N.Y.S.2d 969	Bankruptcy case where debtors assigned right to receive funds to DDC prior to default judgment; no ass'n policies involved.
In re World Trade Diamond Corp (Siegmann)	2/6/1990	N.Y. App. Div. 550 N.Y.S.2d 706	DDC member challenged DDC arbitration ruling as arbitrary and issued without

			adequate notice. Court upheld arbitration award, finding no misconduct, bias, or abuse of power.
In re Namdar (Mirzoeff)	5/10/1990	N.Y. App. Div. 555 N.Y.S.2d 101	DDC member challenged DDC arbitration ruling, claiming bias. Court upheld arbitration award, ruling that alleged bias was known but not raised before arbitration proceeding began.
Barzilay v. Siegman	5/17/1990	N.Y. App. Div. 555 N.Y.S.2d 726	DDC arbitration award contested; court refused to overturn.
People v. Alexander	6/12/1990	N.Y. App. Div. 556 N.Y.S.2d 576	DDC security officer involved in police identification of jewelry thief; defendant later alleged improper testimony.
Israel Discount Bank Limited v. Rosen	1/31/1991	N.Y. App. Div. 565 N.Y.S.2d 29	DDC member challenged DDC arbitration ruling, claiming award was excessive and imposed after statute of limitations. Court upheld arbitration award, ruling that arbitrators had authority to fashion award.
Siegelson's Diamonds & Jewelry, Inc. v. Harry Winston Inc.	8/20/1992	N.Y. Sup. Ct. 1992 WL 352533	DDC involved in search for stolen diamond ring; referenced in this conversion case.
Greenblatt v. Richard Potasky Jewelers, Inc.	1/13/1994	S.D.N.Y. 1994 WL 9754	DDC member plaintiff sued defendants for various causes, including RICO violations. Court dismissed with prejudice.
Elefant v. DDC	1/21/1997	N.Y. App. Div. 653 N.Y.S.2d 782	Withdrawal of appeal from unpublished trial decision.
Banda v. Zadok	09/18/1997	Tex. App. 1997 WL 576369	Defendant received notice of suit through letters to DDC office; no ass'n policies involved.
Sims v. Siegelson	1/15/1998	N.Y. App. Div. 668 N.Y.S.2d 20	DDC arbitration panel held father liable for son's business debts; father claimed no connection to son's business. Lower court vacated arbitration award; appellate court reinstated, citing lack of basis to vacate.
In re Richard Potasky Jeweler, Inc.	3/31/1998	S.D. Ohio 22 B.R. 816	Bankruptcy action involving DDC members; no ass'n policies involved.
South Beverly Wilshire Jewelry & Loan v. Super. Ct.	7/29/2004	Cal. Ct. App. 16 Cal.Rptr.3d 710	DDC filed amicus brief in dispute over diamond consignment; no ass'n policies involved.
Stengel v. Black	08/30/2004	S.D.N.Y. 2004 WL 1933612	DDC member's letter used as evidence in conversion case; no ass'n policies involved.

APPENDIX B – WESTLAW SEARCH FOR ACSA, ATMI, MCE & NGFA CASES^o

Case Name	Date	Court & Citation	Relevant Facts & Outcome
American Cotton Shippers Association (ACSA)			
Bolin Farms v. ACSA	1/31/1974	W.D. La. 370 F.Supp. 1353	Cotton farmers sued to escape contracts after a rise in prices, partly on antitrust claims; contracts held valid.
AFL-CIO v. Marshall	11/14/1979	D.C. Cir. 617 F.2d 636	ACSA party in suit against OSHA for cotton dust regulations; no ass'n policies involved.
AFL & CIO	09/19/1980	D.C. Cir. 1980 WL 29283	Motion for remand granted.
Molsen v. C.I.R.	09/26/1985	T.C. 85 T.C. 485	General counsel of ACSA filed amicus curiae brief in tax dispute; no ass'n policies involved.
American Textile Manufacturers Institute (ATMI)			
Ryder Truck Lines, Inc. v. U.S.	12/4/1969	M.D. Fla. 308 F.Supp. 341	ATMI intervenor in challenge to ICC denial of raised trucking rates; no ass'n policies involved.
Con. Ed. of N.Y. v. Fed. Power Comm'n	5/19/1975	D.C. Cir. 512 F.2d 1332	ATMI intervenor in suit over natural gas plan; no ass'n policies involved.
Transcontinental Gas Pipe Line Corp. v. Fed. Power Comm'n	11/29/1976	D.C. Cir. 562 F.2d 664	ATMI intervenor in suit over natural gas plan; no ass'n policies involved.
Philadelphia Gas Works v. Fed. Power Comm.	5/9/1977	D.C. Cir. 557 F.2d 840	ATMI intervenor in suit over natural gas plan; no ass'n policies involved.
N.C. v. FERC	8/29/1978	D.C. Cir. 584 F.2d 1003	ATMI intervenor in suit over over natural gas plan; no ass'n policies involved.
ATMI v. Bingham	10/03/1978	D.C. Cir. 1978 WL 17190	Motion on unpublished opinion.
AFL-CIO v. Marshall	11/14/1979	D.C. Cir. 617 F.2d 636	ATMI party in suit against OSHA for health standard which linked cotton dust to occupational exposure; standard was upheld. [Appealed in Donovan, below.]
ATMI v. Marshall	10/06/1980	U.S. 449 U.S. 817	Petition for writs of certiorari granted.
ATMI v. Marshall	12/01/1980	U.S. 449 U.S. 1007	Motion for amicus curiae brief granted.
ATMI v. Marshall	12/15/1980	U.S.	Motion for additional time for oral argument

^o All cases in bold include mentions of “antitrust” “restraint of trade” or “Sherman Act.”

		449 U.S. 1059	granted.
ATMI v. Donovan	6/17/1981	U.S. 452 U.S. 490	Appeal of Marshall [above]; wage guarantee portion of OSHA standard vacated and remanded.
Amer. Paper Inst. v. EPA	7/28/1981	4th Cir. 660 F.2d 954	ATMI party to challenge of EPA application of Clean Water Act; no ass'n policies involved.
Belton v. US	10/30/1992	Fed. Cir. 983 F.2d 1086	Motion for government to dismiss own appeal granted with leave to refile.
Belton v. US	9/7/1993	Fed. Cir. 6 F.3d 756	ATMI members "interested parties" in dispute over textile customs from various foreign countries; held not to have standing to appeal. (Appeal dismissed at 983 F.2d 1086.)
U.S. ex. rel. ATMI v. The Limited	11/13/1997	S.D. Ohio 1997 WL 33421319	ATMI suit under False Claim Act dismissed with prejudice for failure to state a claim.
U.S. ex. rel ATMI v. The Limited	05/20/1998	S.D. Ohio 179 F.R.D. 541	Motion to vacate 1997 dismissal denied.
ATMI v. The Limited	9/14/1999	6th Cir. 190 F.3d 729	ATMI sued importers under False Claims Act, claiming mislabeled textile origins; dismissal affirmed. ("Antitrust" mentioned only as example of contingent obligations.)
U.S. ex. rel ATMI v. The Limited	04/03/2000	U.S. 529 U.S. 1054	Petition for certiorari denied.
Memphis Cotton Exchange (MCE)			
Keyer v. MCE	6/10/1916	Tenn. 186 S.W. 593	Keyer sued to recover seat on exchange, which she had leased to party who left debts to MCE at lease expiration. Court held that MCE could deny the membership until debts were paid.
MCE v. J.H. Pope	4/2/1931	Tenn. Ct. App. 13 Tenn.App. 518	Pope used MCE membership as security for a debt; remainder of case involved bank's right to sell membership and other property to collect.
National Grain and Feed Association (NGFA)			
Water Transport Ass'n v. ICC	11/15/1983	2d Cir. 722 F.2d 1025	Consolidated suit over standards of disclosure for reviewing waterway shipping contracts; held not to have standing under Staggers Act where Congress intended claims to be made under antitrust laws.

Brae Corp. v. US	8/24/1984	D.C. Cir. 740 F.2d 1023	Antitrust suit with ICC over train boxcar rates; no ass'n policies involved.
Associated Builders & Contractors, Inc. v. Brock	10/16/1988	3d Cir. 862 F.2d 63	NGFA, as intervenor, challenged application of the "hazard communication standard" by OSHA; standard upheld.
NGFA v. OSHA	10/27/1988	5 th Cir. 858 F.2d 1019 [SUPERSEDED]	NGFA challenged fire/explosion safety regulations from OSHA; case remanded to examine economic feasibility.
NGFA v. OSHA	1/24/1989	5th Cir. 866 F.2d 717	NGFA challenged fire/explosion safety regulations from OSHA; court deferred to OSHA reasoning.
AFL-CIO v. OSHA	7/7/1992	11th Cir. 965 F.2d 962	NFGA intervenor in suit over OSHA limits on toxic substances (Air Contaminants Standard)
NGFA v. U.S.	2/17/1993	8th Cir. 5 F.3d 306	NFGA requested review of ICC approval of certain railroad selling practices; no ass'n policies involved.
Hoffman v. Cargill Inc.	11/15/2000	8th Cir. 236 F.3d 458	In dispute between parties over delivery of grain, Cargill awarded \$465,000 in NFGA arbitration. Hoffman sued to overturn award; trial court vacated arbitration panel. On appeal, Circuit Court reversed and remanded, citing judicial deference to arbitration awards except where "completely irrational".