THE ANTI.TRUST OF REPUTATION MECHANISMS:
INSTITUTIONAL ECONOMICS AND CONCERTED
REFUSALS TO DEAL

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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 efficiency, then per se treatment—or any heightened presumption of illegality—of reputation mechanisms with coordinated punishments is misplaced.

"[I]n business a reputation for keeping absolutely to the letter and spirit of an agreement, even when it is unfavourable, is the most precious of assets, although it is not entered in the balance sheet."

Lord Chandos (Oliver Lyttelton)¹

INTRODUCTION

Though certainly not the first to remark on the value of a good reputation,² Oliver Lyttelton nicely observed how reputations are

² See, e.g., D. Lyman, Jr., The Moral Sayings of Publius Syrus, A Roman Slave: From the Latin 20 (1862) (“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 for contributing to a drunken brawl: “Reputation, reputation, I ha’ lost my reputation! I ha’ lost the immortal part, sir, of myself, and what remains is bestial…” William Shakespeare, Othello, act 2, scene 3 ll. 254–56 (M.R. Ridley ed., 1962).
often called upon to fill the gaps in agreements that are beyond the reach—and even some within the reach—of courts. Prior scholarship has also observed that reputations can serve to monitor product quality,\(^3\) reduce litigation costs,\(^4\) and, the focus of this Article, support executory contracts.\(^5\) In each of these instances, institutions provide reputation mechanisms to enforce pledges that are either unenforceable or too costly to enforce in court.

Could it be, then, that reputation mechanisms amount to an antitrust violation? This Article says, yes, they could, but generally, they should not. They could because (among other reasons) reputation mechanisms foreclose commerce to targeted individuals and can amount to a group boycott, which the Supreme Court as recently as 1998 reiterated is a per se violation of U.S. antitrust law.\(^6\) They should not, however, because many reputation mechanisms arise to govern desirable economic activity, and they do so more efficiently—that is, with fewer transaction costs—than public courts, firms, and other enforcement instruments that antitrust does not scrutinize. To the degree that reputation mechanisms provide net benefits, and to the degree that antitrust law strives to promote economic welfare,\(^7\) reputation mechanisms identify useful


\(^6\)See NYNEX Corp. v. Discon, Inc., 525 U.S. 128, 134–35 (1998) ("The Court has found the per se rule applicable in certain group boycott cases... involving horizontal agreements among direct competitors."); see also cases cited infra note 37. See discussion infra Part II for other ways in which reputation mechanisms may conflict with U.S. antitrust law.

\(^7\)See Reiner v. Sonotone Corp., 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a consumer welfare prescription.") (internal quotation marks omitted); 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
and necessary reforms to current antitrust law.\textsuperscript{8} They also present an opportunity for institutional economics to inform antitrust law, such that the efficiency of an arrangement is evaluated not just by prices and output but also in light of transactional realities and institutional contexts.\textsuperscript{9}

whether the objective is to maximize consumer welfare or total welfare. Compare FTC v. Univ. 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 Bork, supra, at 90 ("Consumer welfare... is merely another term for the wealth of the nation. Antitrust thus... has nothing to say about the ways prosperity is distributed or used.")., and Oliver E. Williamson, Allocative Efficiency and the Limits of Antitrust, 59 Am. Econ. Rev. (Papers & Proc.) 105, 105, 108–09 (1969) ("[A flexible] version of the allocative efficiency criterion [should] become the principal basis for formulating antitrust policy and enforcing the Sherman and Clayton Acts. ... Antitrust might best be enforced by suppressing redistributio

tional considerations. Moreover, where systematic exploitation exists, the indicated remedy is to provide a legislative exception rather than a judicial correction. To involve the courts in such merit choices is inadvisable: 'There can be few more intensely political determinations and few for which the judicial process is less suited.'") (quoting Robert H. Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 74 Yale L.J. 775, 839 (1965)).


\textsuperscript{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 Prods. v. PSKS, Inc., 127 S. Ct. 2705, 2710 (2007) ("The Court has abandoned the rule of per se illegality for other vertical restraints a manufacturer imposes on its distributors... We now hold... that vertical price restraints are to be judged by the rule of reason."). 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." Frank Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 10 (1984).

\textsuperscript{9} Jonathan Adler makes a related point in observing that cooperatives of fishermen employed output-increasing concerted refusals to deal to limit harvesting and conserve fish stocks. Jonathan H. Adler, Conservation Through Collusion: Antitrust as an Obstacle to Marine Resource Conservation, 61 Wash. & Lee L. Rev. 3 (2004). Adler criticizes the local court for finding the fishermen's group boycott to be per se illegal and refusing to recognize the boycott's arguably procompetitive purpose and effect. Id. at 4–7 (discussing Manaka v. Monterey Sardine Indus., 41 F. Supp. 531 (N.D. Cal. 1941)). Adler admirably "explores the tension between antitrust principles and conservation of the marine commons," id. at 8, but does not offer a theory to evaluate the efficiency of group boycotts. This Article provides an institutional economic framework that is readily applied to the \textit{Manaka} decision.

Gary Libecap similarly documents a collection of different collaborations among competitors designed to secure property rights for procompetitive ends, including a price fixing arrangement by shrimp and oyster fishermen. Gary Libecap, Contracting for Property Rights 88 (1993) (discussing The Gulf Coast Shrimpers' and Oystermen's
Since much of antitrust analysis rests on fact-intensive 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 may constitute a paradigmatic illustration of reputation mechanisms and associated group boycotts, since the industry enforces its contracts by relying almost exclusively—without any court involvement—on 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.” 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 provides the factual background. It details how the diamond industry implements a coordinated reputation mechanism to enforce executory contracts and sustain reliable transactions 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. It observes that the industry’s group boycotts rely on horizontal agreements among competitors that normally warrant antitrust scrutiny. 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

Association v. United States, 236 F.2d 658 (1956)). Unlike the normative efficiency analysis offered in this Article, Libecap’s extremely valuable book offers a positive model of institutional change, focusing on “the actual process by which property institutions are changed and whether the changes represent an efficient solution to a particular social problem . . . .” Id. at 2.

Oliver E. Williamson, The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting 35 (1985) (citing Behavioral Sciences Subpanel, President’s Science Advisory Committee, Strengthening the Behavioral Sciences 5 (1962)).
thus appropriately encounter scrutiny from antitrust law, transaction cost economics can guide an antitrust rule of reason analysis that indicates when reputation mechanisms should be permissible. Part IV then discusses some notable cases involving key figures in the U.S. diamond industry and its trade association, the New York Diamond Dealers’ Club. These cases illustrate certain costs of private ordering: the temptation to pursue noneconomic gains, to punish efficient entrants, and to secure rents for industry leaders at the expense of outsiders. Since a rule of reason analysis must weigh the costs of collective self-enforcement against its institutional efficiencies, these cases help demonstrate how to distinguish procompetitive applications of reputation mechanisms from anticompetitive group boycotts.

I. THE SETTING: PRIVATE ORDERING OF DIAMOND TRANSACTIONS

The most significant feature of diamond transactions is the unreliability of state courts in enforcing executory contracts. The typical diamond transaction is a credit sale or a brokerage arrangement—situations in which a diamond or cache of diamonds is in the possession of someone who is not the owner. Because diamonds are easily portable, virtually untraceable, and command high prices throughout the world, a potential thief encounters few obstacles in hiding unpaid-for or stolen diamonds from law enforcement officials, fleeing American jurisdiction, and selling the valuable diamonds to black market buyers. Accordingly, state courts can neither discipline parties nor seize stolen assets that escape their jurisdictional reach. Even sophisticated legal instruments, such as liens or other devices to secure assets as collateral, cannot reliably prevent diamond theft, which in the language of contract law is the failure to pay for a sale on credit. These important limitations on

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11 Much of this Part is adapted from Richman, supra note 5.
12 See id. at 390–92 (explaining the heightened importance of credit, credit sales, and brokers in the diamond industry).
13 Diamonds remain the choice currency of fleeing fugitives. For example, Martin Frankel, the troubled fugitive financier whose collapsed financial schemes prompted federal prosecution, arranged a shadowy purchase of over ten million dollars in diamonds before his attempted escape from U.S. authorities. Ellen Joan Pollack, The Pretender 205 (2002). Diamond theft also continues to be a severe problem for the
the capabilities of state courts force the diamond industry to depend instead on private mechanisms to enforce contracts. Hence, the industry relies primarily on an elaborate reputation mechanism.

The underlying mechanics of reputation mechanisms are well understood. Individuals make decisions to enter into relationships with others based on the past actions of their potential partners. In the commercial context, merchants will refuse to enter into contracts with, or will demand a risk premium from, individuals who have failed to fulfill their previous contractual obligations. In a cooperation-sustaining equilibrium, the prospect of losing future business opportunities (or paying future premiums) is sufficient to deter bad behavior, so 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 each merchant’s history is known to potential exchange partners and (2) imposing a credible and sufficiently painful punishment to deter misconduct. The diamond industry’s rules and structure enable a reputation mechanism that meets these challenges, induces contractual compliance, and thus supports transactional reliability where courts cannot.

A. The Industry’s Rules

The diamond industry’s central nervous system—the mechanisms that 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 1800 members organize the vast majority of America’s commercial traffic in diamonds, with most members acting as middlemen between the diamond producers who mine the stones (most of which are organized by the DeBeers syndicate) and the diamond retailers who convert them into jewelry. Nearly half of the world’s sixty-billion-dollar sales in diamond jewelry are in the United States, and DDC members handle over ninety-five percent of the diamonds imported into the country. Since most diamonds are bought and sold several times before they are ultimately purchased 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 his admission. 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 diamond sales between DDC merchants. For example, the 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 1:00 p.m. the following day, and that DDC-provided scales will determine the official weight of transacted diamonds. The DDC By-Laws also establish rules for transactions with out-of-town dealers, the requirements for maintaining membership in good-standing, and the rigorous process of admitting new members.

The most important of the DDC By-Laws provides for an arbitration panel. Arbitrators are fellow DDC members who have

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17 See id. arts. III (“Members”), XVII (“Out-Of-Town Dealers”).
18 See id. art. XII (“Arbitration”).
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 empower arbitration panels to arrive at prompt and informed rulings. More significantly, the By-Laws provide that any dispute arising between DDC merchants—whether a seller accuses a buyer of missing payment or a buyer accuses a seller of failing to furnish the diamonds that were promised—may only be brought before the DDC’s Arbitration Panel. Members are prohibited from bypassing DDC arbitration and bringing suit instead in New York state courts or any other system of dispute resolution.

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, which immediately makes the default known to all DDC members. News of the individual’s default spreads rapidly throughout the global marketplace as similar

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19 Bernstein, Diamonds, supra note 5, at 135–38, 148–51 (describing at length the many efficiency-enhancing features of the DDC’s adjudication process).

20 Parties who lose in arbitration have limited appeal rights, with DDC rulings final and state courts largely deferential to the industry’s private arbitration. See, e.g., In re World Trade Diamond Corp., 550 N.Y.S.2d 706, 707 (N.Y. App. Div. 1990) (holding that DDC arbitration rulings should be upheld absent evidence of misconduct, bias, or abuse of power). New York courts have overturned DDC arbitration rulings, however, where there is evidence of arbitrator bias or prejudicial conduct. See Goldfinger v. Lisker, 500 N.E.2d 857, 858 (N.Y. 1986) (vacating a DDC arbitration award because the arbitrator engaged in improper private communication with one litigant); Rabinowitz v. Olewski, 473 N.Y.S.2d 232, 234 (N.Y. App. Div. 1984) (replacing DDC arbitrator with an independent arbitrator when one party had cause to fear discriminatory treatment).

21 See DDC By-Laws, supra note 16, art. XII, § 25.
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 in the DDC and other bourses worldwide. Each bourse, which houses restaurants, prayer halls, and other areas where members congregate regularly, is designed to gather merchants together, thereby collecting and disseminating valuable market and reputation information.  

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 future potential trade partners. This 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 DDC 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 of a member in default and the posting of his picture and his arbitration-determined debt on the DDC's wall. Nonetheless, current DDC members will not transact with merchants who were dismissed from the DDC because their own reputations would be discredited by dealing with members who have failed to live up to previous commitments. In short, merchants dismissed from the DDC are shut out of the lucrative diamond business.

22 See Bernstein, Diamonds, supra note 5, at 121 ("The bourse is an information exchange as much as it is a commodities exchange."); Richman, supra note 5, at 397 ("[T]he Club creates both a physical and a relational infrastructure that facilitates information sharing between members."). The bourses are also designed to facilitate social gatherings among merchants, and even retired merchants continue to spend their days in the bourse halls. Consequently, being scorned or ostracized from the merchant community imposes both economic and non-economic harm. See infra notes 23–25 and accompanying text.
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. This tradeoff between long-term versus one-time payoffs is particularly stark for diamond merchants, since most diamond transactions offer a one-time defection opportunity—stealing a cache of diamonds—with an enormous payoff. Thus, an equilibrium of long-term cooperation is realized only if long-term payoffs are both assured and appropriately rewarding.

The diamond industry’s system of rewards and punishments, which is responsible for securing credible contract enforcement, rests on a remarkable network of family and community institutions. Since diamond dealers will only deal with other dealers who maintain a strong reputation, a merchant found by the DDC arbitrators to have defaulted on a contractual obligation will no longer be able to do business with other industry actors. Moreover, merchants almost exclusively come from family businesses, where profitability is dependent on the quality of a family’s reputation and where family reputations are both inherited and bequeathed. Because a good reputation is essentially a prerequisite to enjoying profitable dealings, entry is largely limited to merchants who enjoy some reputational sponsorship and tacit insurance from existing industry players. Thus, family connections create a valuable and otherwise hard-to-obtain entryway into the industry. Conversely, fulfilling contractual obligations and maintaining a good reputation secures not only a lifetime of business but also enables one to confer a good reputation, and the opportunity to secure future business, on one’s heirs. Merchants are thus induced to fulfill their contractual obligations throughout their lifetimes, and the industry overcomes what game theorists typically describe as an end-game problem.

The diamond industry is also deeply connected with community institutions that distribute non-economic benefits to diamond dealers, and these community benefits play a critical role in ensuring cooperation. Merchants almost exclusively come out of tightly knit,
ethnically homogeneous communities (DDC members, for example, come predominantly from traditionally observant Jewish communities) whose members enjoy partaking in the unique club goods that the community offers. The community leaders and institutions that distribute these club goods contribute to the diamond industry's reputation mechanism by doling out benefits to cooperating merchants and withholding them from those who defect. For New York's Jewish merchants, synagogues and other community religious institutions bestow honors and allocate scarce and non-replicable services to respected members while withholding them from community members in lower repute. Consequently, a merchant's business reputation shapes his reputation in, and the enjoyment he derives from, his religious community. These family and community mechanisms secure long-term cooperation and enforce credit sales despite the enormous temptation to cheat a diamond seller.

This reliance on reputations, and on the associated sanctions from both industry and community institutions, means that the reach of the DDC arbitration board is limited to cooperating parties. Merchants comply with the DDC arbitration board not to avoid the brunt of the DDC penalties, but instead to reap the benefits of having good industry and community reputations. Thus, the DDC's actions will only compel compliance from those who have strong preferences to remain active in the industry and respected in their community. Accordingly, the role of the DDC's arbitration board is purely informational, and the power of its dispute resolution system rests solely on the degree to which it can disseminate information about merchant reputations and past dealings. In this sense, the DDC is much like the private judges in the sixteenth-century Champagne Fairs, whose power lay solely in their ability to publicize the names of individuals who shirked contractual obliga-

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25 See id. at 406-09. 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.

26 Id. For a richly detailed window into how observant Jewish communities dispense community services, and for a description of the differences across assorted Jewish religious sects, such that one community's services are nonreplicable in others, see Samuel Heilman, Defenders of the Faith (1992).
tions. Perhaps the continued use of reputations in the diamond industry into the modern era also illustrates important differences between the Champagne Fairs and the diamond trade. Reputation sanctions in the Champagne Fairs were generically applied to all merchants and were later displaced when more effective state-sponsored enforcement became available, but the diamond industry dispenses pecuniary and non-pecuniary rewards that are tailored to the fairly unique preferences and needs of the Jewish diamond merchants. The diamond industry's very unusual structure and reward system remains necessary because of the very extreme risks associated with diamond credit sales and the lack of effective state-sponsored replacements.

Since the DDC's primary role is disseminating the information upon which the collective enforcement mechanisms rely, the reliability of reputation information, not just its dissemination, is also crucial to ensure proper incentives to cooperate. Several forces work to ensure the veracity of industry information sources. The composition of the DDC's arbitration board provides one guarantee of accuracy. 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 nonmeritorious claims, assess the reliability of proffered evidence, and, when appropriate, impose the proper damages. Additionally, the board may respond to

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27 Paul R. 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, 1–4 (1990). The diamond bourses' role in disseminating information has historically been their foremost function, and their less established predecessors were similarly designed to facilitate the flow of information about market participants and business opportunities. See Abe Michael Shainberg, Jews and the Diamond Trade, in 1 The Jewish Directory and Almanac 301, 308 (1984) (tracing the informational purpose and history of diamond clubs to 15th-century Belgium).

28 The diamond industry also restricts participation to parties who have family or community connections with industry players, so fewer unknown parties are entrusted with credit. These entry restrictions—which go hand-in-hand with the natural limited appeal of industry and community rewards—also helps explain the industry's durability. Systems of reputational exchange rely on information systems to establish familiarity, and some systems collapse when they grow to include unknown and unverifiable merchants. See Avner Greif, The Birth of Impersonal Exchange: The Community Responsibility System and Impartial Justice, 20 J. Econ. Persp. 221 (2006).
misinformation and punish any party responsible for spreading inaccurate information about another's reputation. 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. These religious rules and community norms help filter communications to increase their accuracy—deterring the spread of inaccurate 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 the aimless spread of information of questionable veracity.

These enforcement mechanisms—industry arbitrators that disseminate information and merchants and community leaders that coordinate punishment—highlight how the diamond industry's reliance on private ordering differs dramatically from the conventional demand for private third-party arbitration. In most commer-

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29 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, Diamonds, supra note 5, at 127.

30 Jewish law imposes three distinct prohibitions: "knowingly communicating false, negative statements about another" (motzi shem raḥ), "making unflattering, but true, remarks about a person for no reason" (lashon haraḥ), and "recounting to a person gossip heard about him" (rekhilit). Michael J. Broyde, The Pursuit of Justice and Jewish Law: Halakhic Perspectives on the Legal Profession 77 (1996) (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, forbid communicating reputation information that is necessary to sustain a merchant's 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. Cf. id. at 77-78 (describing the necessary conditions for lawyers to repeat damaging information about another); Richman, supra note 5, at 402 (discussing the ways in which these norms support economic exchange). Even though Jewish law only has loose influence on DDC arbitrators, these religious precepts on handling reputational information pervade as social norms within the merchant community and affect both behavior and the perception of others. See Richman, supra note 5, at 402.
cial settings, parties contractually agree on arbitration to reduce the collective costs of dispute resolution. When a dispute arises, the parties proceed to arbitration and receive a judgment, which the victorious party can then enforce against a noncompliant party in state-sponsored court. The Federal Arbitration Act\(^3\) (like similar statutes in other countries) requires that public courts defer to the arbitrators’ ruling, but the legal instruments of state-sanctioned coercion, such as asset seizure and property liens, remain available to enforce the arbitration judgment. Although these public mechanisms are useful for recovering identifiable and fixed assets, they are far less effective in recovering stolen diamonds, which can easily escape a court’s detection and jurisdiction. The diamond industry, therefore, has developed private instruments to enforce contracts and achieve transactional security. In short, whereas most commercial parties choose arbitration to reduce the costs of litigating in public courts, the diamond industry abandons public courts because they offer ineffective enforcement. And whereas the effectiveness of most commercial arbitration depends on ultimate state court enforcement, the diamond industry designs its own arbitration rules to harness its reputation mechanisms and coordinated punishments.

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 coordinated punishment on wrongdoers by foreclosing future business to those who have failed to uphold their commitments in the past. This collection of industry and community institutions has sustained a sixty-billion-dollar industry that has avoided, has not required, and could not be supported by state court enforcement. Could the institutional foundations for the industry’s procompetitive reputation-based enforcement nevertheless amount to an antitrust violation?

It might be said that a clever antitrust attorney can find violations in even the most procompetitive behavior. In fact, finding an antitrust violation in the conduct by the DDC and its members might require very little cleverness. The industry's reputation mechanism is a product of a horizontal agreement among competitors and, depending on how the agreement is characterized, is in tension with several doctrines in antitrust law. Based on the facts previously presented this Part identifies potential diamond industry antitrust violations.

A. Group Boycotts & Tacit Collusion

The diamond industry's reputation mechanism is a coordinated, multilateral effort to punish bad behavior. In this respect, it is 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, 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 enough industry members to foreclose commerce to wrongdoers. For example, if diamond merchants were regularly to transact with a merchant who had 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 would be inadequate to deter breach. Sanctions that are adequate to deter breach will be best achieved if all diamond merchants refuse to deal with individuals who have misbehaved in the past, even when it means relinquishing individual opportunities for profit (and relatedly, merchants who are known

Cf. Edwin S. Rockefeller, The Enduring Nature of 'Antitrust,' 81 Antitrust & Trade Reg. Rep. (BNA) 257, 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.").
to transact with parties with bad reputations must also be subject to a collective punishment).

The reputation mechanism is thus tantamount to a group boycott, or a horizontal agreement among diamond merchants—who are competitors—to refuse to deal with bad industry actors. The Supreme Court has repeatedly held that such agreements are illegal per se. In *Klor's v. Broadway-Hale Stores*, a horizontal agreement that was orchestrated to block sales to a particular retailer prompted the Court to declare that "[g]roup boycotts, or concerted refusals to deal with other traders, have long been held to be in the forbidden category [of restraints]." The Court has condemned with equal vigor horizontal agreements that arise out of industry associations designed to boycott competitors who introduce alternative business practices. In *Eastern States Retail Lumber Dealers' Ass'n v. United States*, the Court ruled against an association of lumber retailers who refused to deal with vertically integrated wholesalers, and in *American Medical Ass'n v. United States*, the Court invalidated the AMA's policy (which claimed to preserve professional standards and ethics) of expelling any physician who worked for a nonprofit health maintenance organization. These rulings are part of a long line of Supreme Court cases declaring

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33 There are, of course, exceptions to the general practice of refusing to deal with anyone who has misbehaved, and the industry has mechanisms that distinguish malicious breaches from breaches that are products of miscalculations or other errors. In these latter instances, the administered punishments are more forgiving, 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 given the frailties and lenience of human nature. But the exceptions are few and far between to ensure that the impending punishment adequately deters deviation and supports equilibrium of cooperation. See Richman, supra note 5, at 402-03 & n.50.

34 *Klor's v. Broadway-Hale Stores*, Inc., 359 U.S. 207, 212 (1959). The Court clarified in *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998), 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.

35 234 U.S. 600, 614 (1914) (holding that a retailer who circulates 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 . . . . ").

36 317 U.S. 519 (1943) (affirming conspiracy convictions under the Sherman Act).
that horizontal agreements to orchestrate group boycotts are illegal per se.37

The case that is perhaps closest to the diamond industry's boycotts is *Fashion Originators' Guild of America, Inc. v. FTC,* in which an association was found to have violated the Sherman Act when it refused to sell to retailers that purchased from pirating competitors.38 Even though the association claimed its practices were "reasonable and necessary" to assert their alleged rights 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."39 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."40

The per se rule against group boycotts contracted slightly in *NYNEX Corp. v. Discon,* in which the Court clarified that "the per se rule [is] applicable in certain group boycott cases."41 The Court approvingly cited the circuit court's ruling that "the per se rule' would apply only if no 'pro-competitive justification' were to be found,"42 and it cited Areeda & Hovenkamp to confirm that "justifications are routinely considered in defining the forbidden cate-

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38 312 U.S. 457, 463–64 (1941).
39 Id. at 468.
40 Id.
42 Id. at 136 (citing Discon, Inc. v. NYNEX Corp., 93 F.3d 1055, 1061 (2d. Cir. 1996)).
gory" of group boycotts. The murky rule that emerges from Fashion Originators' Guild and NYNEX is that although group boycotts face heightened scrutiny (if not classic per se treatment) under the antitrust laws, procompetitive justifications could make group refusals permissible. Self-help efforts to protect legitimate legal interests, however, are not excused if they rest on objectionable restraints of trade. Thus, the diamond industry's efforts to self-police legal contracts, even if necessitated by court failures, and perhaps even if such self-policing has procompetitive justifications, would have difficulty escaping antitrust liability under a strict application of the current caselaw.

The immediate defense to the charge that the diamond dealers have organized a horizontal agreement to exclude certain rivals is, simply, that there is no actual agreement. To be sure, membership in the DDC requires signing onto the association's By-Laws, which constitute an agreement, but nothing in the By-Laws prohibits members from dealing with merchants who have shirked past contractual obligations. However, the practice of refusing to deal with individuals who have breached, despite the obvious profit opportunities for members who would cross the boycott, indicates that each individual member works against his business interests in abiding by the group boycott. Thus, there is support for a finding of tacit collusion or an implied agreement.

The Supreme Court allowed for the possibility that an illegal conspiracy could be inferred without direct proof of an agreement in Interstate Circuit, Inc. v. United States. 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 dis-
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, "[i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it."6 Since the letter coincided with a significant change in the distributors' business practices, and since each distributor faced "risk of a 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 . . . .

Areeda & Hovenkamp state the Interstate Circuit principle succinctly: "[I]f rational defendants would not act without mutual assurances of common action, then the act proves that such assurances took place."48 The Court's later rulings in Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.49 and Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.50 clarified that merely parallel conduct among rivals is not enough to support a finding of illegal collusion. Subsequent cases have therefore looked for what have been called "plus factors" that might indicate where parallel behavior

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49 346 U.S. 537, 541 (1954) ("'Conscious parallelism' has not yet read conspiracy out of the Sherman Act entirely.").
50 509 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).
amounts to a conspiracy. Plus factors that have been found to transform parallelism into conspiracy, or that have allowed a jury to so find, include frequent announcements of important information and future action, mechanisms to share information among rivals, and policies that standardize industry practices.

The reputation mechanism at work in the diamond industry is a clear instance of parallel conduct that is not economically rational without an implicit 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 bourse, 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 of many reputation mechanisms, which

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51 See, e.g., In re Baby Food Antitrust Litig., 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.'" (citations omitted)). Areeda and Hovenkamp explain that the "inelegant term 'plus factors' refers simply to the additional facts or factors required to be proved as a prerequisite to finding that parallel action amounts to a conspiracy." 6 Areeda & Hovenkamp, supra note 48, at ¶ 1433e.

52 In re Petroleum Prods. Antitrust Litig., 906 F.2d 432, 446-47 (9th Cir. 1990) (concluding that advance announcements of price increases, combined with parallel pricing, support a reasonable inference of an illegal conspiracy).

53 Boise Cascade Corp. v. FTC, 637 F.2d 573, 574-75 (9th Cir. 1980).

54 See, e.g., C-O-Two Fire Equip. Co. v. United States, 197 F.2d 489, 493 (9th Cir. 1952).

55 See, e.g., Bernstein, Cotton, supra note 5, at 1763-71 (describing the role of reputations in governing contracts in the cotton industry); cf. Lisa Bernstein, Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms, 144 U. Pa. L. Rev. 1765, 1819 (1996) (discussing the grain and feed industry and noting that "when transactors are aware that an opinion will be written if an arbitration takes place, reputation bonds will be better able to ensure that transactors perform their obligations or settle their disputes").
means that if the DDC is violating the Sherman Act, then other reputation mechanisms might be in violation as well.

**B. Positive Externalities and the Associated Press Doctrine**

Even if there were no horizontal agreement to boycott certain competitive targets illegally, the DDC is a joint venture with by-laws agreed upon by members who are in competition with one another. In this respect, the DDC is clearly the product of a horizontal agreement among competitors. The DDC's rules, and the substance of the agreement that amounts to the creation of the DDC, are therefore subject to the antitrust scrutiny normally applied to joint ventures and industry associations.

Characterizing the DDC as a joint venture removes it from per se scrutiny. The Supreme Court has determined that the automatic per se rule is inappropriate for such purportedly procompetitive collaborations, so joint ventures are judged under the rule of reason. Since the DDC is easily characterized as a collaborative agreement between competing diamond merchants that has the purpose and effect of achieving transactional efficiencies, the proper antitrust analysis would weigh the DDC's procompetitive benefits against any ancillary and unavoidable anticompetitive consequences.

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. The DDC also disseminates market information among merchants and creates a central trading floor to ensure that market prices are well

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56 See, e.g., Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co., 472 U.S. 284, 296 (1985) (“Unless the cooperative possesses market power or exclusive access to an element essential to effective competition, the conclusion that expulsion is virtually always likely to have an anticompetitive effect is not warranted.”); Broad. Music, Inc. v. CBS, Inc., 441 U.S. 1 (1979) (holding that blanket licenses for broadcasting copyrighted music do not warrant application of the per se rule).

57 See Cal. Dental Ass'n v. FTC, 526 U.S. 756, 786 (1999) (Breyer, J., concurring in part and dissenting in part) (“We must also ask whether, despite their anticompetitive tendencies, these restrictions might be justified by other procompetitive tendencies or redeeming virtues.”).

58 On the specific efficiencies created by specialized contract rules, tailored arbitration procedures, and arbitration by industry insiders, see generally Bernstein, Diamonds, supra note 5.
known. Thus, like other bourses, the DDC reduces search costs for buyers and sellers, something especially valuable for diamond transactions since specialized preferences and in-person inspection are important. These and similar benefits of industry associations have been recognized by the Supreme Court as legitimate reasons for competitors to cooperate: the Court noted the procompetitive benefits of uniform industry rules and coordination in *United States v. Terminal Railroad Ass'n*, *NCAA v. Board of Regents*, and *Allied Tube & Conduit Corp. v. Indian Head, Inc.*; recognized the sizeable efficiencies created by centralized systems of communication and information in *Silver v. NYSE* and *Associated Press v. United States*; and showed deference to trade association procedures and industry practices in *Northwest Wholesale Stationers v. Pacific Stationery & Printing* and *Broadcast Music, Inc. v. CBS, Inc.*

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

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60 224 U.S. 383, 403 (1912) (citing positive aspects of railroad-transfer station consolidations and recognizing their “public utility”).
61 468 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.”).
62 486 U.S. 492, 501 (1988) (holding that “private standards can have significant pro-competitive advantages” when appropriate procedures are followed).
63 373 U.S. 341, 366 (1963) (citing the Great Depression as an example of “how essential it is that the highest ethical standards prevail as to every aspect of the Exchange’s activities”).
64 326 U.S. 1, 17–18 (1945) (“It is apparent that the exclusive right to publish news in a given field, furnished by AP and all of its members, gives many newspapers a competitive advantage over their rivals. Conversely, a newspaper without AP service is more than likely to be at a competitive disadvantage.”).
65 472 U.S. 284, 296 (1985) (recognizing that “cooperatives must establish and enforce reasonable rules in order to function effectively”).
66 441 U.S. 1, 23 (1979) (finding that ASCAP’s “blanket license cannot be wholly equated with a simple horizontal arrangement among competitors”).
that social welfare is increased with the addition of each additional competitor and 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. Similarly, in Silver and Allied Tube, the Court scrutinized a joint venture's decision-making structure: in Silver it prohibited the NYSE from excluding a member without evidence that its procedures and membership criteria advanced procompetitive objectives, and in Allied Tube it invalidated an association vote to set industry standards because an interested party had corrupted the election. Trade associations that serve important roles in managing an industry's operation, whether setting industry rules or controlling access to essential facilities, may run afoul of antitrust prohibitions 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, and conversely, a member may

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67 326 U.S. at 9, 12 ("The joint effect of these By-Laws is to block all newspaper nonmembers from any opportunity to buy news from AP.... AP's restrictive By-Laws had hindered and impeded the growth of competing newspapers."); see also SCFC ILC, Inc. v. Visa USA, Inc., 36 F.3d 958, 971 (10th Cir. 1994) ("[The AP's] news gathering and dissemination capacity could not be duplicated and represented in and of itself a limitation on nonmembers.").

68 373 U.S. at 347 (finding removal of telephone connections to traders' office deprived them of "valuable business service which they needed in order to compete effectively as broker-dealers in the over-the-counter securities market").

69 486 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.").

70 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, supra note 16, at art. XII, § 1a.
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. 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. It should therefore come as no surprise that the DDC presents itself as the home to all, not just a selection, of the industry’s important merchants.

Given the social benefits of broad DDC membership, and given the competitive advantages members enjoy over nonmembers, antitrust law could impose restraints on the DDC’s ability to expel members. Associations with positive externalities and collective market power—associations that are subject to heightened antitrust scrutiny—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 objectives and there are no available alternatives to expulsion that could reasonably satisfy those objectives. Exclusion from the DDC, however, is even more severe than exclusion from other networks because it effectively triggers a denial of all future business. Either expulsion from, or denied entry to, the DDC is evi-

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71 Id. at art. XII, § 1a; art. III, § 2b.
72 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. Id. at art. III, § 1. Presumably the positive externalities are subject to physical capacity constraints, but nothing in the By-Laws indicates 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.
73 See 13 Hovenkamp, supra note 37, ¶ 2220a.
74 See *Nw. Wholesale Stationers*, 472 U.S. at 296 (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*, Inc. v. Visa USA, Inc., 36 F.3d 958, 972 (10th Cir. 1994) (accepting the free rider justification to exclude Dean Witter from the Visa credit card network); cf. 13 Hovenkamp, supra note 37, ¶ 2223 (criticizing the Tenth Circuit’s application of the free rider defense in *SCFC ILC* v. Visa).
75 See *SCFC ILC* v. Visa, 36 F.3d at 970–71 (permitting exclusion of Dean Witter from the Visa network because it was reasonably related to Visa’s business purpose and no broader than necessary).
dence that the individual lacks a credible history of reliable and trustworthy behavior. Membership is thus necessary to signal credibility, and denial of DDC membership, like denial of AP membership to competing newspapers, prevents excluded merchants from competing with members.\(^{76}\)

Consequently, the antitrust question becomes whether excluding a targeted merchant "represents the essential reason for the competitors' cooperation or reflects a matter merely ancillary to the venture's operation; whether it has the effect of decreasing output; and whether it affects price."\(^{77}\) Based exclusively on those last two standards, the traditional antitrust standards of prices and output,\(^{78}\) the answer would have to be no. Additional members would increase supply and bring more price competition, whereas excluded merchants would be unable to offer a competitive alternative. The DDC policy of excluding targeted members instead must be justified as a necessary mechanism to secure exchange. Of course, courts are in theory available to enforce contracts, so the DDC's procompetitive justification must rely on the need for extralegal punishments because of the comparative weakness, or outright failure, of public courts.

Is a "court failure" argument a legitimate procompetitive justification under current antitrust law? The case most on-point is Fashion Originators' Guild, in which the Court squarely invalidated an association's self-help efforts to punish allegedly tortious conduct.\(^{79}\)

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\(^{76}\) See Associated Press, 326 U.S. at 13-14 ("The net effect is seriously to limit the opportunity of any new paper to enter these cities. Trade restraints of this character, aimed at the destruction of competition, tend to block the initiative which brings newcomers into a field of business and to frustrate the free enterprise system which it was the purpose of the Sherman Act to protect.").

\(^{77}\) SCFC ILC v. Visa, 36 F.3d at 964 ("Underlying these cases is an effort to... assure that the procompetitive goals, in fact, are neither undervalued nor mask a reduction in competition.").

\(^{78}\) 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. at 107–08 ("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. CBS, 441 U.S. at 19–20 ("[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... ").

\(^{79}\) 312 U.S. 457 (1941).
Decrying the Guild as an “extra-governmental agency,” the Court refused to consider whether the group boycott had procompetitive justifications.\(^8\) The diamond industry’s reputation-based enforcement system, like the Guild’s enforcement mechanisms, is designed to protect economic interests that are not reliably secured by state courts. Unless the language in *Fashion Originators’ Guild* is modified,\(^9\) the DDC’s efforts to protect its members’ legitimate contractual rights—efforts that are far more effective than using the public courts—may lack a recognized procompetitive justification.

In sum, the centrality of the DDC subjects its membership policies to heightened antitrust scrutiny under the *Associated Press* doctrine. Because the DDC is a joint venture among competitors in which membership is vital to sustaining a profitable business, the exclusion of certain merchants could adversely affect competition. And since inclusive membership policies offer positive externalities that increase both output and competition, exclusion of members could also reduce total surplus. The *Associated Press* doctrine therefore permits the DDC to exclude members only if exclusion is pursuant to a procompetitive justification that is essential to promote the purpose of the venture. The procompetitive purpose behind exclusion is to deter and punish those who fail to comply with their contractual obligations, but the Supreme Court has not yet recognized extralegal punishment as a valid justification. In theory, diamond merchants may enforce those rights in state court, but the Supreme Court might be hesitant to sanction extralegal punishments as severe as exclusion if exclusion also has anticompetitive consequences on prices and output.\(^2\) It would seem that the DDC’s

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8 Id. at 465 (finding the group of manufacturers to be “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 [Sherman Act].’”) (quoting Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 242 (1899)).

9 Id. at 468 (“[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.”).

2 Another reason the Supreme Court might hesitate before allowing the industry to have such broad latitude to police itself with such severe punishments is that it might be hard to distinguish exclusion designed to serve procompetitive goals from naked exclusion with undeniably anticompetitive consequences. The case of Martin Rapaport might fall into the latter category. When the DDC terminated his membership
membership policies would survive antitrust scrutiny only if the Court is responsive to efficiency rationales on grounds that explicitly acknowledge the efficiencies of private enforcement over public ordering in state courts.

C. Sharing Information and Facilitating Anticompetitive Practices

Even if the DDC's membership policies were to survive antitrust scrutiny and the joint venture were permitted to exclude merchants who did not comply with the dictates of the DDC arbitration board, the DDC might still violate the Sherman Act if it coordinated practices that facilitated 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. Such coordination 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 Co. v. United States* and *United States v. American Linseed Oil Co.* found Section 1 violations where industry associations had disseminated information on prices, sales, and 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." The caselaw on such "facilitating practices" generally scrutinizes the effects of information sharing, such as whether the coordinated exchange leads to uniform actions or patently anti-competitive outcomes. The Court is especially suspicious of agreements to exchange information when they are deemed to

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for distributing a newsletter that published market prices for assorted stones, Rapaport appealed to the Federal Trade Commission, which terminated its investigation after Rapaport and the DDC reached a settlement. See infra Part IV.B.

83 257 U.S. 377 (1921).
84 262 U.S. 371 (1923).
86 13 Hovenkamp, supra note 37, ¶ 2112. Courts additionally examine contributing factors such as market power, product homogeneity, and other features that can facilitate collusion. Id.
trigger conduct that amounts to a per se violation, such as an agreement to fix prices or output.

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 sales was enough to violate the Sherman Act. Even though the practice of distributing the names of targeted firms was little more than an agreement to disseminate 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.... [H]e is blind indeed who does not see the purpose in... this report to put the ban upon wholesale dealers....

The DDC By-Laws constitute a horizontal agreement to exchange information with a purpose and effects that are parallel to those that motivated the “blacklist” in *Eastern States*. The DDC’s arbitration board and other information mechanisms disseminate the names of individuals who have failed to live up to their industry commitments, and the motivation for doing so is to provoke a collective refusal to deal. Even if the DDC does nothing more than disseminate information, this joint venture to share information among competitors could amount to an antitrust violation if it triggers a concerted refusal to deal.

Perhaps the best defense of the DDC’s information sharing lies in *Cement Manufacturers Protective Ass’n v. United States*, in which

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87 Id. ¶ 2112c (collecting cases).
88 See, e.g., Hartford-Empire Co. v. United States, 323 U.S. 386, 427–28 (1945) (condemning a horizontal agreement to share production “forecasts” that triggered output quotas).
89 *E. States Retail Lumber Dealers’ Ass’n v. United States*, 234 U.S. 600 (1914).
90 Id. at 608–09.
91 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. The attack on one’s character is unmistakably sweeping and reminiscent of Casio’s lament of the downfall of his own reputation. See Shakespeare, supra note 2.
92 See supra Section II.A.
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. The Court concluded that the collective investigation and sharing of information on customer compliance was reasonable to avoid purchaser fraud. 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 are far more sweeping. In *Cement Manufacturers*, the consequence of investigating and finding fraud was to cancel the individual contract, whereas the DDC’s information dissemination is designed to trigger a sweeping boycott and is much closer to the kind of concerted action the Sherman Act was designed to prevent. For similar reasons, the DDC’s information exchange is also unlike more routine agreements among competitors to share information about the credit-worthiness of certain buyers, which are permitted under the Sherman Act even when they lead to uniform conduct if there are independent reasons for denying credit. When these agreements lead to uniform action, they ostensibly reflect a common perception of a credit risk posed by a certain party, whereas DDC-facilitated boycotts are less related to specific risk assessments and are designed instead to punish and deter certain conduct throughout the industry.

Although the DDC’s information sharing arrangements may facilitate boycotts, there are compelling reasons they should survive antitrust scrutiny. Antitrust law is more permissive of reciprocal arrangements when the exchanged information does not concern price or output and there is an additional recognition that credit

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93 268 U.S. 588 (1925).
94 Id. at 604 ("[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.").
95 Id. at 596–97, 606. 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.
96 See, e.g., Zoslaw v. MCA Distrib. Corp., 693 F.2d 870, 885–86 (9th Cir. 1982) (approving competitors’ exchanges of credit histories and information on credit balances); Michelman v. Clark-Schwebel Fiber Glass Corp., 534 F.2d 1036, 1043 (2d Cir. 1976) (permitting competitors to deny credit to buyer after sharing credit information since their denial decisions were reached independently).
history is expensive to produce and thus is reasonable to share. Moreover, many antitrust authorities would hesitate to punish the dissemination of information that is useful to market participants. Nevertheless, if the DDC’s information-sharing agreement has the purpose and effect of triggering group boycotts against targeted competitors and is intimately linked to anticompetitive conduct, then the agreement to share information itself could amount to an antitrust violation. Of course, this agreement to gather and disseminate certain information on past conduct is essential to support a reputation mechanism, and without this agreement, a reputation mechanism would not be sustainable. In fact, nearly 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. If the DDC’s information sharing violates the Sherman Act, then similar reputation mechanisms might as well.

III. INSTITUTIONAL EFFICIENCIES AS AN ANTITRUST DEFENSE

Thus, a formal application of current antitrust law presents a number of arguments that might lead a court to conclude that New York’s diamond dealers and the DDC are in violation of 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. If diamond merchants are equally limited in justifying their conduct, then antitrust

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77 See Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice § 5.3b, at 219 (3d ed. 2005) (“[E]xchanges of credit information on customers, or the histories of customer dealings, are generally legal. . . . Exchanges of information totally unrelated to price or output generally raise no antitrust issues.


79 As previously noted, the Supreme Court recently reiterated that the per se rule still applies to certain horizontal group boycotts. See NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998); FTC v. Superior Court Trial Lawyers Ass’n., 493 U.S. 411, 433 (1990) (“[W]hile the per se rule against price fixing and boycotts is indeed justified in part by ‘administrative convenience,’ . . . [t]he per se rules also reflect a longstanding judgment that the prohibited practices by their nature have ‘a substantial potential for impact on competition.’” (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984))).
law might foreclose an efficiency analysis altogether. Additionally, unless antitrust law permits collective self-help when courts fail and recognizes the institutional efficiencies that make group boycotts superior to alternative enforcement mechanisms, the diamond merchants' concerted action might still violate the Sherman Act, even under the rule of reason or a less sweeping per se rule.

On its face, prohibiting the diamond industry's use of reputation mechanisms seems to transgress what might be the prime directive of antitrust law: thou shalt not condemn agreements that enhance consumer welfare. The industry relies on a reputation mechanism because public courts are unable to enforce diamond credit sales; therefore, the concerted refusal appears to support the sixty-billion-dollar-a-year industry. If analysis of 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.

Even under a rule of reason analysis, however, where procompetitive justifications are permitted, the mere endurance of the industry does not confirm the desirability 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 in light of the available alternatives. This question arises from the related observations that the merchants' horizontal group boycott is not necessary to support exchange and that the industry's reputation mechanism is not the only conceivable privately administered instrument to assure transactional certainty. If the industry were prohibited from organizing a reputation mechanism to enforce contracts, the industry would avoid collapse by seeking alternative mechanisms to support exchange.

One governance strategy that effectively secures diamond transactions is vertical integration, in which transactions are internalized within a firm where managers can tightly supervise employees. Other segments of the industry successfully use this strategy, with most of the world's diamond mining and large-scale diamond cut-

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100 See discussion supra note 7.
ting occurring within vertically integrated firms. In fact, diamond-cutting firms of all sizes have enjoyed success in monitoring employees for generations, even under strenuous and uncertain circumstances. In the years during World War II, for example, 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 had no previous history in the diamond trade. Nonetheless, many of these refugees were able to establish small cutting operations by employing local workers.102 Currently, most diamond cutting occurs in large factories in India, Thailand, and China that employ inexpensive, low-skilled labor and rely on governance mechanisms that include careful employee monitoring and internal security. Mining companies also employ common administrative mechanisms to supervise employees and prevent theft, and the Gemological Institute of America (“GIA”), where gemologists examine and grade diamonds within a closed, tightly secured complex, also relies on firm-based monitoring to secure its diamond inventory. All of these large-scale operations have the common feature of resorting to hierarchical organization to manage large quantities of diamonds that regularly are in the possession of workers who do not own the stones.103 Mechanisms

103 It should be noted that many of the large-scale mining and cutting operations resort to disturbingly 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 in grim hostels on the mining site. See Alex Duval Smith, The Gem Trail—Diamonds—From Angolan Mine to Third Finger Left Hand, Indep., Feb. 13, 1999, at 18. (In De Beers' defense, Harry Oppenheimer, who controlled the company from 1954–94, was an outspoken critic of Apartheid as a member of South Africa's Parliament. See Donald G. McNeil, Jr., The Oppenheimer Diamond Cartel May Be Forever, N.Y. Times, Jan. 12, 1999, at Cl.) 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." David Buchan et al., The Deadly Scramble for Diamonds in Africa, Fin. Times, July 10, 2000, at 6. 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 Namibian mine involved pigeon fanciers who recruited miners to bring homing pigeons into the mine in lunchboxes and strap diamonds to their feet.
available within these firms have effectively prevented theft and flight, and these same mechanisms should be available to New York’s merchants. Therefore, 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.

If antitrust law is concerned with efficiency and consumer welfare, the legality of the diamond industry’s concerted group boycotts should be determined by the institutional efficiency of the reputation mechanism. Just as antitrust law recognizes “market failure” justifications for certain collaborations,\(^{104}\) it should also recognize a “court failure” justification that would evaluate institutional alternatives in light of a public court’s inability to provide the contractual security a merchant group requires. Antitrust law should thus incorporate transaction costs into the efficiency analysis, move beyond the traditional and narrower antitrust inquiry into prices and output, and employ a comparative institutional analysis to determine the relative efficiencies of alternative mechanisms to govern transactions. To do so, it might consult Transaction Cost Economics (“TCE”), which assesses alternative mechanisms to secure transactions, including vertical integration and “hybrids” such as reputation mechanisms, and examines and compares their relative efficiencies.\(^{105}\)

See Smith, supra. Large cutting 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 Commissioner on Diamonds Workers’ Plight, Times of India, September 16, 2001, 2001 WLNR 6431832 (Westlaw). Indian cutters are also subject to severe sanctions by their employers if suspected of stealing diamonds. See, e.g., Rs 1 Lakh for Family of Diamond Cutter Beaten to Death in Surat, Express News Service, Apr. 30, 2008, http://www.expressindia.com/latest-news/Rs-1-lakh-for-family-of-diamond-cutter-beaten-to-death-in-Surat/303537/ (“Raju Parmar, who worked as a diamond cutter with Akshar Diamonds, was severely beaten up under the suspicion that he had stolen a diamond given to him for cutting and polishing.”).


The Antitrust of Reputation Mechanisms

A. 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 more efficient governance.106

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. Policymakers, led by Donald Turner, then-head of the Antitrust Division of the Department of Justice, were adherents to Joe Bain’s structure-performance-conduct approach to industrial organization, which suggested that vertical restraints were evidence of market power.107 This neoclassical economic orthodoxy bred deep skepticism of vertical agreements, causing enforcement agencies to “pursue[] the dictates of price theory with a vengeance.”108 Most vertical restraints were presumed to be anticompetitive expansions of monopoly power, and enforcement agencies regularly condemned categories of vertical agreements such as tying arrangements, exclusive dealing contracts, territorial agreements, and vertical mergers. Under Turner’s reign, antitrust enforcement in these areas reached its zenith,109 and he was famously quoted to

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106 See, e.g., id. at 3, 12, 54.
107 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 381 (2d ed. 1968). The DOJ’s 1968 Merger Guidelines confidently noted that “market structure generally produce[s] economic predictions that are fully adequate.” Department of Justice Merger Guidelines, reprinted in 2 Trade Reg. Rep. (CCH) ¶ 13,101, § 2 (1998).
109 It was at around this time that Justice Potter Stewart remarked, “the sole consistency that I can find . . . in [merger] litigation under § 7, is that the Government al-
have said, "I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law." Thus the "inhospitality tradition" to both vertical restraints and to TCE-based justifications for such restraints was born.

The inhospitality tradition culminated in the Department of Justice's 1968 merger guidelines, which forbade mergers between parties with nominal market power. Oliver Williamson, the pioneer of TCE, later quipped that "mergers were challenged that did not remotely pose anticompetitive concerns." Over time, however, this hostility to vertical restraints could not withstand growing skepticism. Ronald Coase in 1972 lamented the myopia in contemporary economic theory, saying "when an economist finds something—a business practice of one sort or another—that he does not understand, he looks for a monopoly explanation." In addition, TCE and other theories began generating constructive justifications for vertical restraints, especially for vertical mergers. Oliver Williamson's 1975 book, *Markets and Hierarchies*, which perhaps marked the official launch of TCE and led scholars and antitrust policy-
makers "Toward a New Institutional Economics," \(^{113}\) pressed that "[t]he policy implications of [institutional economics] that are of principal concern are those having to do with antitrust." \(^{114}\) To the degree that policymakers consult institutional economics for matters spanning vertical integration, conglomerate organization, dominant firms, and oligopoly, Williamson predicted that "antitrust enforcement will proceed more selectively in the future.\(^{115}\) The transaction cost approach soon made its way into the world of legal scholars. Robert Bork adopted a TCE approach toward understanding vertical mergers, remarking that "[w]hat antitrust law perceives as vertical merger, and therefore as 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." \(^{116}\) And Frank Easterbrook, shortly before his appointment to the bench, also embraced the TCE template when he asserted that "[t]he dichotomy between cooperation inside a 'firm' and competition in a 'market' is just a convenient shorthand for a far more complicated continuum." \(^{117}\)

Criticism of the applied price theory approach, coupled with the success of TCE and other institutional approaches, led the Department of Justice in 1982 to revise its guidelines for vertical mergers substantially. The revised Guidelines expressly reflected transaction cost reasoning, with nonstandard forms of organization no longer creating a presumption of anticompetitiveness.\(^{118}\) Further revisions to the Guidelines in 1984 made antitrust policy even more permissive toward vertical mergers, holding that vertical mergers


\(^{114}\) Id. at 258.

\(^{115}\) Id.

\(^{116}\) Bork, supra note 7, at 227. Bork is significantly more expansive than Williamson, remarking that "Antitrust's concern with vertical mergers is mistaken.... The vertical mergers the law currently outlaws have no effect other than the creation of efficiency." Id. at 226.

\(^{117}\) Frank Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 1 (1984). To be fair, this remark (like Bork's, see supra note 116) embraces an approach that began with Ronald Coase's seminal article, The Nature of the Firm, 4 Economica 386 (1937), and predated TCE.

\(^{118}\) See Merger Guidelines, 47 Fed. Reg. 28493 (June 30, 1982).
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.\textsuperscript{119} Policy-makers' permissive approach to vertical agreements and mergers has not been unwavering. For example, the FTC launched select challenges against major vertical mergers in the 1990s, and the Commission's stated concern that the mergers might foreclose competition in upstream and downstream markets contained echoes of the inhospitality tradition.\textsuperscript{120} Some have described the FTC's heightened scrutiny as a product of what is called the post-Chicago school of law and economics, which relies on more contextual and complex economic analysis than the simpler Chicago school formulations,\textsuperscript{121} but critics have warned that post-Chicago school theorists threaten to undermine the substantial and valuable contributions made by TCE.\textsuperscript{122} Nonetheless, the Department of Justice has not revised its vertical merger guidelines since 1984, and the recently retired FTC Chairman, Timothy Muris, indicated that TCE and related organizational perspectives remain central to antitrust policymaking when he described his approach as "neither Chicago School nor Post-Chicago, but rather 'New Institutional Economics.'"\textsuperscript{123} Regardless of the contours of the current debate, there is a general consensus that TCE "had a major influence in changing the


\textsuperscript{120} 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. (CCH) ¶¶ 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.


\textsuperscript{122} Paul L. Joskow, Transaction Cost Economics, Antitrust Rules, and Remedies, 18 J. Law Econ. & Org. 95, 105 (2002) ("At the present time TCE and [the post-Chicago school] are like passing ships in the night. The development of sound antitrust legal rules and remedies would benefit from integrating these approaches and recognizing that they are complements rather than substitutes. Otherwise [the post-Chicago school] runs the risk of returning us to the 1960s ... ").

\textsuperscript{123} Stephen Stockum, An Economist's Margin Notes: The Antitrust Writings of Timothy Muris, 16 Antitrust 60, 60 (2002). Muris notes that NIE combines "theory with a study of real world institutions [and] ... is heavily empirical," offering "a welcome relief for many to move away from what [he] refers to as the 'very stale' Chicago/Post-Chicago debate over economic ideology." Id.
The Antitrust of Reputation Mechanisms

antitrust treatment of vertical integration and nonstandard vertical contractual arrangements in ways that are widely viewed as being socially beneficial. \(^{124}\)

Transaction cost lessons for horizontal agreements, however, have been less explored, even as horizontal collusion remains the paradigmatic antitrust concern. \(^{125}\) Since the agreements that bind competing diamond dealers are quintessentially horizontal, any TCE lessons drawn from the diamond industry can inform a more general antitrust approach toward horizontal restraints. Moreover, since collusion in the diamond industry is designed to solve a contracting problem, and since TCE is principally an effort to understand contracting problems, with particular focus on understanding the challenge of credible contracting, transaction cost logic readily offers a template with which to evaluate the efficiencies of the industry's reputation mechanism. Despite the fact that the industry's collective action falls outside the classical TCE framework, TCE still illuminates why collective action in the diamond industry is both procompetitive and minimizes transaction costs when compared to institutional alternatives.

**B. Institutional Economics and Group Boycotts**

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


\(^{125}\) See, e.g., Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 348 n.18 (1981) (ruling that all horizontal agreements on price, including those setting maximum prices, are per se illegal and noting that "horizontal restraints are generally less defensible than vertical restraints"). Of course, vertical agreements—which receive less antitrust scrutiny and more attention from institutional economists—can often resemble or facilitate horizontal agreements. See, e.g., Victor Goldberg, Free Riding on Hot Wheels, Antitrust Bulletin, Winter 2002, at 603, 603 (describing the characterization problems associated with Toys "R" Us, Inc., 126 F.T.C. 415 (1998), and related cases). Interestingly, Goldberg argues that Toys "R" Us illustrates an instance where a horizontal agreement by manufacturers to deal exclusively with one retailer, and boycott other retailers, could amount to a procompetitive joint venture to purchase retailing services. Id. at 612–16.
costs and competencies of various governance mechanisms. The motivation behind this approach is that alternative organizational forms have different proficiencies that make them suitable for different transactional contexts; thus, 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 holds that governance structures align with transactions such that transaction costs are minimized. Accordingly, the attributes of both vertical integration and group boycotts 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 teaches that vertical integration supplies transactional security that contract law or market mechanisms cannot provide, but vertical integration also imposes countervailing costs. Resting on Frederich 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 enable rapid adaptation to demands for economic change. Accordingly, TCE 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.

At first glance, the diamond industry's coordinated system of private ordering might seem to enjoy the benefits of both markets and vertical integration. On the one hand, the economic actors who transact in diamond sales are individual merchants who, unencum-

126 See Williamson, supra note 105, at 94–101. The method of comparing institutional alternatives goes back to Herbert Simon, who encouraged departing from "highly quantitative analysis" and instead employing "a much more qualitative institutional analysis, in which discrete structural alternatives are compared." Id. at 94 (quoting Herbert A. Simon, Rationality as Process and as Product of Thought, 68 Am. Econ. Rev. 1, 6 (1978)).
127 Id. at 46–47.
128 Id. at 103. Since vertical integration is at an extreme on a spectrum of governance mechanisms, it is usefully thought of as a "last resort." Id.
129 Id. at 104–05.
bered by the bureaucratic costs of vertical integration, feverishly monitor market information and attentively respond to opportunities. On the other hand, the industry's use of coordinated boycotts effectively punishes contract breaches and thus assures transactional security. Two features, however, distinguish the diamond dealers' private ordering 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 canonically deals with the vertical relation (and addresses what is classically called "the question of vertical integration"). The second is that the diamond industry's network is a product of a multilateral agreement, whereas TCE focuses on the individual bilateral transaction.

These departures from the traditional framework require a slight modification to the standard TCE tradeoff between transactional security and incentive intensity. Whereas multilateral private ordering might enjoy both, it also introduces transaction costs of another sort. Multilateral private ordering empowers private actors to exclude unknown or unfamiliar parties from a commercial network, and though the ability to exclude is at the core of the reputation mechanism—and thus central to securing transactions—it closes the industry to many benefits of competition. The ability to exclude introduces the danger that the commercial network will become a cartel that colludes on output, prices, or suboptimal business standards. Early illustrations of how cooperation breeds

130 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, the brokerage contracts are designed to harness the power of market incentives while minimizing agency costs. See Richman, supra note 5, at 415. The Bourse's organization is responsible for supporting contracts that economize on these assorted transaction costs.

131 Williamson, supra note 113, at 6; see generally id. at 82–131.

132 For example, Williamson notes that for John R. Commons, "the transaction was held to be the ultimate unit of economic investigation." Id. at 3 (citing John R. Commons, 1 Institutional Economics: Its Place in Political Society 4 (1934)). 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. Pol. Econ. 288, 290 (1980), but even this perspective views the "contracts" as a series of vertical relationships stemming from a principal.
anticompetitive collusion include some Medieval merchant guilds, such as the German Hansa, that initially facilitated welfare-enhancing contract enforcement but gradually slipped into welfare-reducing monopolistic behavior. Exclusivity also closes the industry to potential innovators or outside talent that could introduce dynamism and discontinuous improvements. Much of the literature on discontinuous innovation, for example, indicates that dramatic improvements in efficiency and value tend to be introduced by new entrants rather than incumbents. Finally, as many antitrust cases illustrate, empowering private industry actors to exclude competitors introduces the substantial danger that that power will be abused, perhaps to replace market forces with the ill-informed judgment of industry leaders, or worse, to protect the private benefits of industry insiders.

For these reasons, systems of commerce that rely on personal exchange and multilateral private ordering—which are subject to the costs of exclusivity—suffer from significant dynamic inefficiencies. Economic history has shown that enforcement mechanisms that employ reputational sanctions and support personal exchange tend to succumb to systems of impersonal exchange, which Avner Greif calls "the hallmark of the modern economy." Much of the historical movement toward impersonal exchange was driven by incentives to expand trade and create wealth by including traders from unfamiliar communities. Many departures from private sys-

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133 Avner Greif, Institutions and the Path to the Modern Economy: Lessons from Medieval Trade 122 (2006) ("Thus a merchant guild that had facilitated trade in the late medieval period was transformed into a monopolistic organization that hindered trade expansion during the pre-modern period.").


135 See supra notes 35–38, 60–69 and accompanying text.


137 Greif, supra note 133, at 311 ("Arguably, reputation-based institutions that support personal exchange have a low fixed cost but a high marginal cost of exchanging..."
tems of personal exchange were also a function of the structural costs of exclusivity. Systems of personal exchange that relied on familiarity also encountered size constraints, for example, and therefore could not capture the benefits of scale and diversity. Since there are limits to the number of individuals with whom merchants can be familiar and can trust, the growth of certain merchant circles limited the ability to verify a trading partner’s reputation and thus eroded the credibility of personal exchange. Thus, some systems of personal exchange failed to compete with impersonal exchange because they could not grow fast enough, and others failed because they grew beyond their capacities.138

Introducing the costs of exclusivity into the standard tradeoff between transactional security and incentive intensity yields the comparative institutional analysis reflected in Table 1.139 The table suggests that both vertical integration and multilateral private ordering are superior to market transactions supported by state-sponsored courts when public courts offer inadequate transactional security. More important, the table posits that multilateral private ordering is superior to vertical integration when the costs of exclusivity are lower than the incentive-diluting costs of vertical integration.

with unfamiliar individuals. Law-based institutions, which enable impersonal exchange, have a high fixed setup cost but a low marginal cost for establishing new exchange relationships.”).

138 Greif, supra note 28, at 222 (2006) (“By fostering impersonal exchange and institutional development, the community responsibility system laid the basis for its own replacement by overarching systems of law-based exchange.”); see also id. at 231 (“Ironically, the [community responsibility] system seems to have undermined itself; the processes it fostered were those that increased trade and urban growth—the causes of its decline.”).

139 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 59.
Applying this template to the diamond industry explains why the industry’s system of coordinated punishment is a more efficient enforcement mechanism than the alternatives—and why it should therefore be permissible under antitrust law. First, the paramount importance of transactional security for diamond merchants is highlighted by the extreme costs of potential thefts—this explains the undesirability of publicly ordered market exchange. Second, and more significant, the diamond industry is a paradigmatic setting in which the gains from maintaining high-powered incentives outweigh the costs of exclusivity. 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 create significant variation in the ultimate buyer’s willingness to pay. Heterogeneous 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 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 buyers' idiosyncratic needs with the distinct qualities of available stones.\(^\text{140}\) 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 and sellers and buyers gather together to form a frenetic, high-volume spot market. More generally, the DDC and the organizational structure of New York's diamond merchants exemplify a common template for exchange houses of all kinds, where merchants and market information are assembled to facilitate an optimal matching process.

Meanwhile, the costs of exclusivity have not been as severe for the diamond industry as they would be for most others. Although the diamond industry is open only to those who, either through an earned reputation or family connections, can credibly commit to a credit sale,\(^\text{141}\) the number of merchants in various diamond centers approaches levels at which collusion or coordination would be difficult, despite the assorted community connections that many members share (the New York DDC, for example, is home to nearly two thousand members\(^\text{142}\)). Moreover, the nature of the industry suggests that there are limits to the benefits of technological innovation. The process of matching individual stones with tacit and idiosyncratic preferences—the force responsible for the structure of the distribution system—largely rests on the need for in-

\(^\text{140}\) 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. Even as sales have globalized and 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.

\(^\text{141}\) Since a good reputation is a prerequisite to entering into and succeeding in the industry, yet success is the primary avenue to attain a good reputation, the emphasis on reputations reinforces the industry's exclusivity. Good reputations, however, can also 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 explain how community institutions can bestow a competitive advantage for members over nonmembers. See Richman, supra note 5, at 410–11.

\(^\text{142}\) See Bernstein, Diamonds, supra note 5, at 119.
person inspection, and modern-day diamond cutting requires separate attention to each stone. Thus, there are meaningful limits on how much an innovation could achieve economies of scale.\footnote{There are certain efforts to codify and categorize stones so that their values can be 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 1 1995, http://www.jckonline.com/article/CA6258319.html (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”).}

More important, even though the industry’s system of wholesale distribution—where the reputation mechanisms are at work—is closed to outsiders, other distribution channels are available to lead diamonds from mine to jewelry manufacturer. Other bourses compete with the DDC, and some Internet marketers have tried to forge alternative distribution systems. Additionally, the industry is not entirely closed to merchant networks that have extralegal methods of securing exchange, and the industry has witnessed entry by ethnic groups able to adopt and sustain the industry’s reputation mechanisms.\footnote{Although entry is essentially impossible for most individuals, the industry does appear to permit entry to groups who can sustain the industry’s reputation mechanism credibly. Indian merchants who are Palanpuri Jain, an insular sect that has a history of cutting diamonds and other gemstones, have managed to acquire approximately ten percent 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.} Thus, even though the DDC’s particular distribution network might be exclusive, alternative distribution systems can—and have—entered the global market. Nonetheless, the ethnic-based system of diamond distribution, which Jewish diamond merchants have maintained for several centuries, has remained intact despite these competitive threats and other economic challenges.\footnote{See id. at 385–89.} Only the boldest conspiracy theorist would suggest that entry barriers could secure a stranglehold over an industry for nearly a millennium 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.
To be sure, the costs of exclusivity to the diamond industry—and ultimately to diamond consumers—are certainly positive and quite significant. For example, the industry’s exclusivity means it cannot recruit at business schools or elsewhere to collect top business talent, and it is largely insulated from consumer preferences, especially from consumers who are not connected with the ethnic groups that dominate the industry. Moreover, exclusivity might be responsible for protecting ossified practices, incremental thinking, and conformity. Chaim Even-Zohar, a gadfly and widely respected diamond industry analyst, calls the diamond industry “an opaque, fragmented, and complacent value chain” that has failed “to come to terms and to respond to changing societal norms, more exacting consumer demands, and fierce competition for the consumer’s surplus disposal income.”

The diamond manufacturers and traders saw no compelling need for change. Decades of reliance by virtually all players in the value chain on the price support provided by the rough supplier’s cartel operations (which had always assured long-term profitability through maintaining supply and demand disequilibria) had stifled entrepreneurship. There was very little risk-taking associated with bold and innovative marketing programs.

Thus, exclusivity imposes costs even on the diamond industry, and multilateral private ordering is by no means a costless enforcement mechanism. Yet the transaction cost approach evaluates real-world structural alternatives, not costless hypotheticals, and a comparative institutional analysis of the available alternatives suggests that the concerted group boycott is the mechanism that most efficiently meets the industry’s need for transactional security. If institutional efficiencies were incorporated into an antitrust analysis of the diamond merchants’ exclusive conduct, the multilateral enforcement system would accurately be regarded as an effort to secure transactions while minimizing transaction costs. Consequently, if the rule of reason were applied, coordinated punishment

147 Id.
in the diamond industry would be deemed a procompetitive collaboration rather than an instance of anticompetitive collusion.

More generally, this institutional analysis reveals systematic procompetitive features of concerted refusals to deal. A tradeoffs analysis confirms that systems of multilateral private ordering impose certain transaction costs of their own, but it also reveals that these mechanisms offer transactional security under high-powered market incentives and thus can enforce contracts at lower transaction cost than alternative mechanisms. Multilateral private ordering introduces other costs, but those costs should be evaluated within a comparative assessment that recognizes the corresponding benefits. Accordingly, antitrust law should approach group boycotts and other forms of multilateral private ordering with less inhospitality than is prescribed by current caselaw. It should continue to move away from the per se rule, consider whether particular boycotts arise as solutions to difficult transactional challenges, and employ institutional economics in assessing their relative efficiency.

C. Extensions: Additional Applications of Institutional Economics & Antitrust

Applying institutional economics to horizontal group boycotts, such as the collaboration that creates the enforcement system for New York's diamond merchants, expands its application beyond the conventional inquiries into vertical agreements. And just as institutional economics has already had a significant influence on antitrust policy toward vertical restraints, it also offers broader lessons for antitrust policy toward horizontal restraints. Incorporating institutional analysis to antitrust policy would encourage policymakers to understand the economic forces that affect organizational forms and ownership structures, thus generating useful tools to evaluate the competitiveness of certain market structures.

For example, the analysis of the DDC suggests more generally that antitrust law should take a more lenient approach to multilateral collaborations with market power. In *Northwest Wholesale Stationers*, 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 remanded to the appellate court for a review of the district court's rule of reason
Even as the Court limited the applicability of the per se rule, however, it noted that the rule still applied to cooperatives with market power or exclusive access to an element that is essential to compete. 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." In NCAA, the Court held 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. A similar approach was employed by the Tenth Circuit in SCFC ILC v. Visa, which ruled that the network of banks that offer Visa credit cards was not obligated to include a financial institution that also offered a competing credit card since the collaborative's exclusive rules were "necessary" to prevent competitors from free-riding. Institutional economics suggests that the requirement of necessity should be relaxed. Even if certain restrictive organizations are not essential to producing certain services, their restraints might still serve pro-competitive ends. The DDC and its reputation mechanism, for ex-

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149 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 predominately anticompetitive effects.... Some showing must be made that the cooperative possesses market power or unique access to a business element necessary for effective competition.").
151 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.").
152 SCFC ILC, Inc. v. Visa USA, Inc., 36 F.3d 958, 970 (10th Cir. 1994) ("Visa USA urges its concern about protecting the property it has created over the years and preventing Sears and American Express, successful rivals, from profiting by a free ride does not represent a refusal to deal or group boycott but is reasonably necessary to ensure the effective operation of its credit card services.").
ample, are not essential to support diamond trade since vertical integration is a feasible alternative, but they are efficient arrangements of distribution. An examination of institutional efficiency, rather than a determination of necessity, might offer a reason for an even narrower application of the per se rule.

Underlying the "essential" requirement is some confusion behind whether to approach the ownership structure of certain industries from an ex ante or ex post approach. Joint ventures are primarily deemed essential to support a product when an ownership structure is presumed to be exogenous. Areeda and 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.\(^{153}\)

Institutional economics, however, teaches that ownership arrangements are efficient responses to transaction costs and other market forces. They are thus as much consequences as they are drivers of market conditions. A particular ownership structure, therefore, should not delimit the antitrust analysis; on the contrary, comparing the efficiencies of a particular ownership structure with its alternatives should be at the core of the analysis. This ex post perspective on ownership and market structure perspective was a common mistake of the early price theorists and has apparently been repeated by some in the post-Chicago school. Paul Joskow, for example, attributes the Court's mistaken analysis in *Kodak v. Image Technical Services* to placing undue emphasis on the ex post relational situation while ignoring the more important ex ante competition. He warns that perpetuating this ill-advised approach "could turn antitrust policy... back to where it was in the 1960s or worse."\(^{154}\)

\(^{153}\) 13 Hovenkamp, supra note 37, ¶ 2220b2.

\(^{154}\) Joskow, supra note 122, at 108. Applying the ex ante institutional approach to sports leagues, for example, would require antitrust policy to examine why most leagues are joint ventures of independently owned teams, rather than divisions of a
In sum, antitrust law does not have an explicit recognition of institutional efficiencies when it evaluates horizontal restraints, but institutional economics and, specifically, TCE have much to offer. These institutional approaches suggest that certain concerted refusals to deal among 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 demands procompetitive justifications from horizontal collaborations, it usually looks for efficiencies motivated by price theory (such as standard setting or network externalities).\textsuperscript{155} It should also look for institutional efficiencies and permit TCE to inform both the limited application of the per se rule and the implementation of the rule of reason analysis.

IV. ANTITRUST ENFORCEMENT AND DIAMOND DEALERS: APPLYING THE RULE OF REASON

The previous Part suggests not only that concerted refusals should be judged under the rule of reason but also how the rule of reason should be applied. The anticompetitive consequences of group boycotts are to be evaluated against their procompetitive justifications, and among those justifications is the recognition that coordinated boycotts serve to deter contract breach when public courts are ineffective. Group boycotts should accordingly be permitted under the Sherman Act when they arise to compensate for court failures and when an institutional economic analysis determines that they are more efficient than alternative private ordering mechanisms.

One of the dangers of multilateral private ordering, however, is that the private power to exclude could be abused, and antitrust law should attempt to distinguish between group boycotts employed for procompetitive and anticompetitive ends. The contemporary history of New York’s diamond industry reveals that the same mechanisms that foster transactional security efficiently have

also imposed the costs of exclusivity. This Part reveals that industry leaders have used the arbitration and boycott mechanisms to advance noneconomic purposes, target innovators or industry nonconformists who might unsettle the current economic hierarchy, and obtain preferential treatment for purely personal gain. Perhaps the primary lesson from this history is, as TCE teaches, that governance mechanisms introduce tradeoffs, and that the costs of certain institutional arrangements should be recognized alongside their benefits. This lesson extends to antitrust law as well. Antitrust should recognize both the benefits and the drawbacks of various multilateral enforcement mechanisms, avoid both categorical condemnation (which is reflected in per se rule) and approval (which is given by some scholars\footnote{See, e.g., Lisa Bernstein, Private Commercial Law, in 3 The New Palgrave Dictionary of Economics and the Law 108, 113-14 (Peter Newman ed., 1998) ("In sum, private legal systems increase the value of transactors' written contracts [by improving quality and reducing the costs of adjudication]. However, they also play an even more important role in increasing the value of the extralegal aspects of contracting relationships by, among other things, increasing the effectiveness of reputation bonds and other nonlegal sanctions."); Yochai Benkler, Coase's Penguin, or, Linux and The Nature of the Firm, 112 Yale L.J. 369 , 444 (2002) ("[P]eer production has a systematic advantage over markets and firms in matching the best available human capital to the best available information inputs in order to create information products."). Even Robert Ellickson's seminal and widely respected Order Without Law credits tight-knit groups for "maintaining norms whose content serves to maximize the aggregate welfare that members obtain in their workaday affairs with one another" without recognizing the corresponding costs of exclusivity. Robert C. Ellickson, Order Without Law: How Neighbors Settle Disputes 167 (1991). These expressions of categorical praise for group boycotts and coordinated social norms overlook the significant organizational and transaction costs that coordinated reputational sanctions introduce, discussed infra at notes 134-39 and accompanying text.}, and evaluate the legality of particular boycotts based on their economic purpose and effect.

A. 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 associated with Nazi organizations and business interests.\footnote{Transcript of Oral Argument at 3–4, United States v. Diamond Center, Inc., C. 138-285 (S.D.N.Y. Aug. 26, 1953).} In 1949, when more than eighty percent of
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DDC members were refugees or family of victims from the Lowlands of Europe, 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.

On June 23, 1952, the Department of Justice's Antitrust Division filed a complaint against the DDC 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."

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 in its services or products[and t]hat each defendant shall take steps to expel from its membership or otherwise discipline any dealer violating the terms of the agreement."

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

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159 Transcript of Plaintiff's Interrogatories Addressed to Defendant at 14, United States v. Diamond Dealers Club, Inc., No. 76-343 (S.D.N.Y. Sept. 1 1954). 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 Transcript of Oral Argument at 3-4, United States v. Diamond Center, Inc., C. 138-285 (S.D.N.Y. Aug. 26, 1953).
160 Complaint at 4, Diamond Dealers Club, No. 76-343 (S.D.N.Y. June 23, 1952). Also listed as a defendant was the Diamond Center, Inc., which was described with the DDC as a "trade association whose members are dealers in diamonds." Id. at 2. 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 4. The Complaint also notes that "[m]embership 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. . . . [S]uspension or expulsion from either association results in suspension or expulsion from all associations which are members of the World Federation." Id.
161 Id. at 5.
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 and of genocide, and of murder, rape, arson, robbery and similar crimes. Over ninety-nine percent 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. 162

The defense was unconvincing to the Department of Justice, and in 1953, negotiations with antitrust policymakers in Washington and New York persuaded the DDC to change its not-guilty plea to a plea of nolo contendere. The DDC thereafter pledged to cooperate with antitrust enforcers and adopted a provision in the DDC By-Laws that prohibited all restraints of trade. 163

The court, in accepting the DDC's plea, also was unsympathetic to what the DDC's attorney explained was conduct motivated "purely on a moral and religious ground." 164 The presiding judge asserted that

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. 165

Current antitrust law, of course, would be unsympathetic for a very different reason. Group boycotts are not sanitized because they

162 Answer at ¶ 10, Diamond Dealers Club, No. 76-343 (S.D.N.Y. Nov. 17, 1952). The DDC also argued that the boycott of German goods and merchants had no material economic impact and that it constituted political expression protected under the First Amendment. Id. ¶¶ 19, 22.
163 See supra note 44.
165 Id. at 10. The defendants assured the court that they would forgive, though did not pledge to forget. Id. at 12.
seek to advance noneconomic justifications, and the DDC’s targeted boycott would be condemned as a naked restraint.\footnote{FTC v. Superior Court Trial Lawyers Assoc., 493 U.S. 411, 431–32 (1990) ("A rule that requires courts to apply the antitrust laws 'prudently and with sensitivity' whenever an economic boycott has an 'expressive component' would create a gaping hole in the fabric of those laws.").}

This poignant story of a historically disenfranchised immigrant community asserting some political autonomy illustrates the temptation to abuse a procompetitive multilateral system of private ordering to pursue noneconomic objectives and cause anticompetitive harm. The temptation to hijack the power to exclude extends into less compelling situations, and political ideology continues to interfere with the DDC’s policies and procedures.\footnote{See Rabinowtz v. Olewski, 473 N.Y.S.2d 232 (N.Y. App. Div. 1984) (ruling that the DDC's arbitrators would be irreversibly biased against a party linked to connections with the Palestinian Liberation Organization).} Furthermore, however repentant the DDC was before the court in pleading \textit{nolo contendere}, the event is viewed retrospectively as a proud instance of vindication.\footnote{As one subsequent Chairman of the DDC put it many years later: “Despite that plea \textit{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. . . . But the words of Nathan Math, and their impact on those who heard him, gave the Club the victory it sought.” Albert J. Lubin, Diamond Dealers Club: A Fifty-Year History 15 (1982).}


Martin Rapaport is a successful and ambitious diamond dealer who in 1978 started publishing the \textit{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 \textit{Rapaport Diamond Report} and now covers all matters of interest to the diamond industry, brought much-desired transparency to diamond market prices. Although subscriptions spread throughout the DDC and the entire diamond industry, many dealers complained that prices quoted in
the Report were frustratingly low. 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, 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. Tension between Rapaport and many of the DDC's elders spilled into the broader Jewish community, with a Jewish religious court ordering Rapaport to stop publishing his pricelist (threatening excommunication) and Rapaport receiving death threats, including one telephoned from a matzah factory in Brooklyn.

The first legal shot was fired on December 9, 1981, when "counselors for unnamed diamond dealers" petitioned the Federal Trade Commission to investigate the business conduct of the Rapaport Diamond Corporation. The complaint alleged that Martin Rapaport, as both a diamond broker and a publisher of a weekly newsletter, was "artificially fixing prices in the diamond industry by disseminating an unsubstantiated price report." The FTC staff launched an initial phase investigation but found no evidence of

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169 Rapaport v. Diamond Dealers Club, Inc., 1983 WL 14942, at *1 (N.Y. Sup. Ct. Feb. 23, 1983). Ironically, a current complaint with the Rapaport Diamond Report is that the quoted prices are too high. See Teresa Novellino, Rap Takes Heat Over Price List Increases, National Jeweler Network, June 3, 2008, http://www.nationaljewelernetwork.com/njn/content_display/diamonds/e3i5d0b266ef36902817016ea54d7f06bf3. These complaints over prices that purportedly reflect current demand and supply are explained, in part, by Rapaport's dual role as a publisher of prices and as a dealer holding a private inventory. Charges of bias will likely continue to hound the Rapaport Report as long as Rapaport stands to profit personally from the manipulation of his published prices.

170 See Sandra Salmans, A Diamond Maverick's War with the Club on 47th Street, N.Y. Times, Nov. 13, 1984, at A1 ("[T]he directors of the Diamond Dealers Club . . . complain that the Rapaport report is, in effect, setting prices. Mr. Rapaport says that he is merely reflecting the marketplace.").

171 Id.

172 FTC Staff Request for DOJ Clearance, Matter #821-0041 (Bureau Of Competition Jan. 6, 1982).

173 Id.
any conspiracy to manipulate diamond prices, and it closed the investigation on June 7, 1982.\textsuperscript{174}

The dispute reached a "boiling point" that same month when Rapaport made highly critical comments in an industry magazine article about diamond investment firms,\textsuperscript{175} many of which were run by prominent DDC members.\textsuperscript{176} Invoking a provision in the By-Laws authorizing the DDC Board of Directors to expel any member for making "any statement, act or conduct that in the Board's sole judgment and discretion reflects adversely upon the integrity of any member of the Organization,"\textsuperscript{177} the DDC Board voted to expel Rapaport. Rapaport promptly sued the DDC in New York state court, demanding readmission to the DDC and seeking $55 million in damages.\textsuperscript{178}

These events once again invited the scrutiny of the FTC, but this time the Commission's attention was directed at the DDC's exclusionary and predatory conduct against Rapaport. In February of 1984, the FTC Commissioners authorized an investigation into

\textsuperscript{174} Memorandum from Claude Trahan et al. to Leroy C. Richie, Matter #821-0041 (Bureau of Competition June 1, 1982). The complaint was filed as a Section 1 claim under the Sherman Act and was referred to the FTC's horizontal restraints program. The staff investigation noted, however, that "because there seemed to be a question as to the accuracy of some of the prices reported," and thus a possibility that Rapaport was using false reporting in his newsletter to manipulate wholesale diamond prices to benefit his own diamond sales, Rapaport's conduct would be better scrutinized under section 2, for possible attempts to monopolize the market. Id. The investigation nonetheless concluded that the wholesale market was very unlikely to be monopolized by Rapaport or by any other dealer. See id. ("Staff did not consider it in the public interest to pursue this theory because the newsletter's gross sales amounted to only about $300,000 and because additional price reporting services have recently emerged."). The confusion of the complaint, and the sparse evidence to support accusation, suggests that the "unnamed diamond dealers" were launching a nuisance complaint.

\textsuperscript{175} Salmans, supra note 170.


\textsuperscript{177} Rapaport, 1983 WL 14942, at *1 (quoting DDC By-Laws, supra note 16, at art. VII, § 2). Although the language of the By-Laws appears 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.

\textsuperscript{178} See Salmans, supra note 170.
whether the DDC or its members had "entered into agreements to unreasonably restrain trade or commerce by obstructing the collection and dissemination of information concerning current diamond prices." Subpoenas were issued to DDC officers and other prominent figures in New York’s diamond industry, and despite the DDC’s repeated claims that its dispute with Rapaport was a private matter, the Commissioners found sufficient evidence of harm to competition to authorize a full-scale investigation.

The entire matter settled in early 1986. Rapaport was readmitted to the DDC, his full standing in New York’s diamond community was secured, and the DDC Board and members took no 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. Lisa Bernstein concludes from the incident that “[t]he norms of the diamond industry only work when they capture information that the market values,” and that the DDC’s failure to expel Rapaport is attributed to the value generated by his Report. There are, however, less sanguine lessons to draw. Like the DDC’s attack on dealers of German goods in the 1950s, the Rapaport affair illustrates how personal animus and differing business philosophies can hijack the DDC’s exclusionary power to bar innocent parties inappropriately. More significantly, the incident illustrates how the industry’s established powers can be hostile to nonconformists and innovative entrepreneurial mavericks. Harnessing group boycotts to target innovative entrepreneurs is not just a misuse of the industry’s reputation mechanism, it also undermines the very procompetitive justification for permit-

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179 Secretary’s Matters, Open Meeting of the Fed. Trade Comm’n, Matter #821-0041, at 32 (Bureau of Competition Sept. 18, 1984).
180 Id. at 32, 38, 42. 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. Id. The DDC had been far more accommodating to the DOJ’s investigation three decades earlier.
183 See Bernstein, supra note 5, at 139 n.50.

In May 2002, Brett Stettner, a retail jeweler from Galveston, Texas, travelled to New York to purchase wholesale diamonds and to obtain expert advice on cutting a 25.4 carat internally flawless diamond worth between $1.5 and $2.5 million. For both of these tasks, Stettner obtained assistance from Boruch Twersky, a DDC diamond dealer and broker. Stettner put the 25.4 carat stone in the possession of Twersky and also had Twersky facilitate a disputed quantity of sales.185

A dispute later arose between Stettner and Twersky when Stettner asked for the diamond's return. Twersky claimed that the diamond was collateral for some $200,000 worth of diamonds that Stettner agreed to purchase from assorted dealers who used Twersky as a broker. Stettner countered that the diamond was never intended as collateral, that he had received less than $82,000 of diamonds on credit from Twersky and his associates, and that he had only received an invoice for $200,000 after suing to recover the 25.4 carat stone.

When Stettner, who was not a DDC member, brought suit in New York state court, Twersky claimed that the DDC had exclusive jurisdiction over the dispute since Stettner signed a "Non-membership Application and Agreement" that bound him to DDC.


The issue before the court was whether this non-membership agreement extended to Twersky's help in cutting the 25.4 carat stone, which in part was dependent on whether the stone were intended to serve as collateral for other credit purchases. Testifying on Twersky's behalf were Isaac Merin, the dealer for whom Twersky brokered sales to Stettner, and Jacob Banda, another diamond dealer and Chairman of the DDC. Stettner had separate dealings with Banda, which had developed into a disagreement, and Stettner alleged in his complaint that Twersky told him he would only return the 25.4 carat diamond "when the separate 'dispute' with Banda had been resolved to Banda's (and his) satisfaction, and not before." Thus, Stettner found himself up against a team of DDC members, all of whom were asking the New York court to cede jurisdiction to the DDC's arbitrators.

The Stettner-Twersky dispute is a classic insider-outsider conflict, in which the outsider reasonably fears that he will receive unfair treatment from the industry arbitrators, especially when the head of the DDC acts as an interested party. Recent opinion concerning the quality of DDC's arbitration confirms that outsiders like Stettner increasingly expect biased results. An industry watchdog remarked, "[i]n recent years we have witnessed a serious erosion of [mutual] trust" in the industry's arbitration system, and increasingly, there are "bourse members who believe that an Israeli arbitration panel will always decide against a New York party and that a New York arbitration panel will always go against an Israeli party in the dispute." There also is a growing problem with judgments rendered in absentia, where one party—usually a nonmember of the presiding bourse—claims not to have received fair notice.

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186 Under the DDC's By-Laws, a non-member can only enter the DDC as an invited guest of a member. DDC By-Laws, supra note 16, at art. XVII. Twersky sponsored Stettner's visit to the DDC so Stettner could purchase diamonds. Stettner, No. 602298/06, at 2.


before a default judgment is rendered against him. And DDC arbitrators have been further accused of being complicit in schemes by fellow DDC members to swindle consumers with inflated and fraudulent GIA certificates.

Stettner v. Twersky and the "in absentia" cases illustrate the flip side of many of the benefits of relying on DDC arbitration to resolve disputes. Because arbitrators are insiders with industry expertise, they purportedly can issue judgments with greater accuracy, flexibility, and speed than generalist judges or juries, but the same insider status also threatens the arbitrators' impartiality and objectivity. Because of the failure of public courts to enforce diamond contracts, the authority of the arbitrators and the reputation mechanisms they trigger are relied upon to secure order in the industry, but this reliance on private actors only magnifies the danger of partiality. To the degree that antitrust law is asked to scrutinize concerted actions against outsiders like Stettner, it should distinguish coordinated efforts to extract rents from outsiders from the procompetitive boycotts that target individuals found to have deviated from their contractual commitments.

The industry's arbitration system cannot survive, of course, without a minimum degree of credibility. If DDC arbitration rulings are perceived to be tainted by bias, arbitrariness, and ideology, then parties might turn instead to alternative instruments. Merchants might construct complex contracts that rely less on credit and more

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190 Id.; see also Affidavit in Support of Motion to Show Cause ¶ 7, Sanghvi v. Diamond Dealers Club, Inc., No. 7601085 (N.Y. Sup. Ct. Mar. 28, 2007) ("It was obvious that the [DDC] was not attempting to reasonably consider the issues of jurisdiction or whether I was even involved with the claim, but instead wanted to protect its members . . . .") The problems concerning DDC arbitration are reaching a crisis point for some. These and other recent developments have compelled one observer to conclude that "the quality of [DDC] arbitration (i.e., the kind of justice that is being rendered) has so deteriorated, that people are resigning their Diamond Dealers Club membership, to avoid the chance that in a business dispute they may be forced to agree to arbitration." Email from Chaim Even-Zohar to Barak Richman, Professor of Law, Duke University School of Law (July 10, 2008) (on file with author).

191 Chaim Even-Zohar, Bourse Leadership, Arbitrations, and Fraudulent GIA Certificates, Diamond Intelligence Briefs, February 26, 2008, at 4676.

192 See supra Section I.B; Bernstein, Cotton, supra note 5, at 1741.

193 A recent proposal to eliminate term limits for DDC officers, which has been described as an effort to permit Banda "to become president-for-life," would cement partiality and further insulate the DDC from market pressures that demand credible rulings. Chaim Even-Zohar, supra note 191.
on collateral that public courts, despite their costs and deficiencies, might capably secure; the industry might see more vertical integration, despite the associated bureaucratic costs; or reputation circles might become smaller, relying less on DDC membership to signal credibility and resorting to more intimate personal exchange.

In fact, many of these developments have started taking place—greater use of state courts, more reliance on formal banks for sources of credit, and more integrated distribution channels—in large part because of the costs of relying on multilateral private ordering to support exchange. These developments have led to the recent observation that "[t]he diamond industry is in the middle of a constructive upheaval."  

CONCLUSION

Even as reputation mechanisms remain a fixture in the economy and a topic of fascination among academics, they may run afoul of the antitrust laws. This Article recognizes that beneficial reputation mechanisms can be characterized as horizontal agreements to implement group boycotts, that these agreements could be literal violations of current antitrust law, and that antitrust law therefore requires reform. This is because antitrust law has yet to recognize explicitly the institutional efficiencies of horizontal agreements that arise in response to what is best described as a court failure. Transaction cost economics offers an affirmative justification for horizontal restraints that enable collective contract enforcement, and it thus suggests that antitrust law should move away from per se or heightened scrutiny and instead adopt a more tolerant approach to certain concerted refusals to deal. Reputation mechanisms and their corresponding group boycotts can contribute to procompetitive collaborations that promote efficiency, and they should therefore be permissible under antitrust laws that are dedicated to maximizing consumer surplus. Institutional analysis also warns,

194 See id. ("The DDC, once upon a time one of the most important and prestigious bourses in the world, sees its membership declining."); Chaim Even-Zohar, Reflections on Diamond Industry Financing in a BASEL II Compliant Environment, Dia-Compliance, Fall 2007, at 1 (detailing several modern financial instruments, rather than credit based on reputations, that are increasingly used to finance diamond purchases).

195 Chaim Even-Zohar, supra note 146, at 1.
however, that multilateral private ordering is associated with its own substantial costs. Concerted group boycotts can exclude innovators and benevolent outsiders and harness private governance for private gain. An antitrust analysis should therefore evaluate whether a particular group boycott is designed to achieve procompetitive multilateral private ordering or to secure anticompetitive rents.

The most immediate implication for antitrust law is that it should not apply the per se rule to concerted group boycotts. The per se rule is applied only to practices that "'always or almost always tend to restrict competition and output,'" and the procompetitive use of group boycotts in the diamond industry—a stark illustration of a more general phenomenon—indicates that the per se label does not fit. But a broader consultation of institutional economics might yield many more lessons for antitrust law as well. Institutional economics should be useful, as illustrated here, in helping antitrust policymakers distinguish anticompetitive group boycotts from procompetitive joint ventures to enforce contracts. 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. While a transaction cost economics analysis of the Diamond Dealers Club, an idiosyncratic trade association within an oddly structured industry, suggests a relatively minor reform to antitrust law, it also reveals the ways in which new methodologies can broadly inform antitrust analysis.