The Antitrust Enterprise

PRINCIPLE AND EXECUTION

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Preface

The operating principles of every discipline must periodically be reexamined. Too much mischief results when the everyday rules of the law lose connection to their foundations and acquire a life of their own. This book originated in many law school and economics classes and seminars devoted to the effective administration of the antitrust laws. More than any other forum, classroom encounters have challenged me to identify antitrust's most fundamental and realistic aspirations.

I have too many intellectual debts to list here, but I must mention one. Phillip E. Areeda was my senior coauthor for nearly fifteen years prior to his untimely death in 1995. He helped me to understand and make order out of this discipline, to appreciate its significant limitations, and to articulate and define its rules. His life's work, the multivolume *Antitrust Law* treatise that he and Donald F. Turner began in the 1970s, has now become my life's work as well.

I am also indebted to the University of Iowa—and particularly to the two deans under whom I have served, N. William Hines and Carolyn Jones—for ample support of my research. Finally, and gratefully, I dedicate this book to my father, Bert Hovenkamp.

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Introduction

After decades of debate, today we enjoy more consensus about the goals of the antitrust laws than at any time in the last half century. By contrast, antitrust's rules for decision making remain unfocused and imprecise. Few people dispute that antitrust's core mission is protecting consumers' right to the low prices, innovation, and diverse production that competition promises. Articulating the means to achieve this end is a different matter. Policy makers continue to dispute questions about the robustness of markets; about the extent to which strategic business behavior exists and whether antitrust can do much about it; about where the most protection is needed and what form it should take; about the special role of antitrust in regulated or deregulated industries; and about the proper relationship between antitrust and innovation.[1]

The modern debate over basic antitrust goals began during the era when Earl Warren was Chief Justice of the Supreme Court (1953–1969). Under Warren antitrust cases became relatively easy for plaintiffs to bring and win, and they were highly likely to go to jury trials unless fearful defendants settled out of court. But too often the protected class seemed to be small business rather than consumers. Indeed, many Warren-era decisions condemned conduct precisely *because* it reduced costs or generated more desirable products.[2] Such practices harm rivals unable to match them, but they benefit consumers. On top of that, Warren Court antitrust was highly distrustful of markets, suspicious of innovation and the intellectual property laws, and convinced that aggressive antitrust remedies would make the economic world a better place. The result, wrote Robert H. Bork, the most influential critic of Warren-era

antitrust policy, was a mélange of incoherent policies that confused competition with small business protection and was probably worse than no antitrust policy at all.[3]

The antitrust counterrevolution of the 1970s and 1980s challenged every one of these values. The procedural limitations placed on plaintiffs became severe, and far fewer antitrust cases go to trial today. The only articulated goal of the antitrust laws is to benefit consumers, who are best off when markets are competitive. But the definition of "competitive" has changed as well. The Warren Court defined "competitive" as a market containing many firms, the small ones having a "right" to compete with the bigger ones. Today antitrust policy generally defines "competitive" in the economic coin of low prices, high output, and maximum room for innovation. The academic lawyers and economists of the Chicago School, who were responsible for much of the counterrevolution, sometimes conceded that firms could engage in anticompetitive strategic behavior. But outside of remedies for collusion, they found little promise in antitrust cures. Rather, they believed that markets are generally robust and tend to correct themselves, and that government intervention is as likely to make things worse as better.

A few things seem clear about this dramatic switch in perspective. *First,* in the 1960s and 1970s the Supreme Court went overboard in protecting small business from larger firms, often at the expense of consumers. However, the Supreme Court had no clear vision about how much society should be willing to pay for such protection, or exactly who the beneficiaries should be. *Second,* the rise of the Chicago School in the 1970s was a much needed corrective, restoring rigor that had been lost, and identifying a protected class—consumers—and some rules for assessing how they could best be protected.

But, *third,* at least some parts of the counterrevolution went too far. Historically, the Chicago School tended to regard only price-fixing and large mergers as within the competence of the courts. While more complex forms of behavior might be anticompetitive, the courts generally were thought to lack the ability to develop rules for these problems without doing more harm than good. At the same time much of so-called "post-Chicago" antitrust, discussed in Chapter 2, has wandered too far to the opposite extreme, identifying problems and solutions that are beyond the competence of the court system to comprehend and correct.

Fourth, during the mid-twentieth century United States policy was deeply suspicious of patents and other intellectual property rights. We tended to see intellectual property as inherently monopolistic and in need of control. Antitrust policy responded not merely by creating severe limits on anticompetitive abuses of intellectual property rights, but also by imagining threats to competition where none existed. The result was silly rules that often deprived creative entrepreneurs of their innovations even when they posed no competitive threat. And the outcome of limiting intellectual property rights in haphazard, unforeseeable ways is a reduced incentive to innovate. In the last two decades, however, this pendulum has swung to the opposite extreme. Congress has continuously expanded the scope of patent and copyright, and we have become much more tolerant of practices that were routinely condemned a few decades ago. A strong case can be made that today we overprotect at least certain intellectual property rights, perhaps severely so. This problem is in the first instance not one for the antitrust laws, but it necessarily shows up in the attitude that antitrust takes toward intellectual property practices that are alleged to be anticompetitive. In evaluating such claims the first job for antitrust is to determine that competition really has been threatened.

Fifth, the transition from regulatory to antitrust control of deregulated industries has gone far more smoothly in some markets than in others. During the New Deal the United States embarked on top-to-bottom regulation of many industries, including electricity and natural gas, communications, banking, insurance, securities, land use, and interstate transport, including airlines, railroads, and trucking. Government agencies often specified the prices that regulated firms could charge (through tariffs filed by the firms themselves), restricted the entry of newcomers, and required firms to justify any expansion into a new territory or product. Along with regulation came various degrees of antitrust immunity, most generally under the theory that the regulatory agency should oversee anticompetitive abuses. But much of this regulation was an economic failure. Regulation is costly, produces haphazard results, is not good at making firms minimize their costs, and impedes innovation. Furthermore, agencies are too frequently "captured" by the very firms they are supposed to control. Only a few markets work so badly that elaborate price and entry regulation is worth these substantial costs.

Under "deregulation," which emerged in the 1980s, regulation was re-

laxed in each of these industries, competition was restored, and antitrust given a new role. But antitrust's record in these formerly regulated markets has been mixed. It has succeeded in markets where regulation was never appropriate in the first place, such as trucking; and in markets where changes in technology have facilitated competition among numerous rivals, such as long-distance telecommunications. It has largely failed in markets that require hardwired networks, such as local telephone service or retail electricity. Where deregulation has worked well, antitrust has slipped in rather easily to fill the void. But where deregulation has worked poorly, the role of the antitrust laws remains highly uncertain, and they are often misapplied. In some cases we have simply replaced regulation-by-agency with regulation-by-antitrust-trial, which is far worse.

Sixth, confidence in the federal courts as principal administrator of the antitrust laws is higher than it was two decades ago. Nevertheless, the overall record of the federal courts remains spotty. Lack of adequate Supreme Court supervision has led to many divisions among the federal courts of appeal. Jury trials continue to produce indefensible outcomes. The remedies system is badly designed. The courts rely excessively on experts engaged by the parties, often with unacceptable results. In general, although the courts have become better at identifying problematic market *structures,* they have not done so well in dealing with complex anticompetitive *strategies,* where they continue to permit juries to make decisions that the judge feels incapable of making.

Dealing with these problems is not easy. Often their roots are systemic, originating in the Constitution or inherent in the structure of the antitrust laws themselves, which assign the overall power of interpretation to generalized federal courts. The Seventh Amendment provides for a jury trial upon demand in damage actions, and the antitrust laws contain a liberal provision of threefold (treble) damages for prevailing plaintiffs. Jury trials in front of intelligent but nonspecialist judges is a truly miserable way to make economic policy, but federal courts do it all the time in the guise of enforcing the antitrust laws. The current phenomenon of greatly overused private enforcement leads to the closely related problem of unprincipled experts, whose skills at persuading an untutored jury are often much greater than the quality of their economic or market analysis. The courts have responded to these problems by developing a remarkably expansive doctrine of "summary judgment," or the

judge's power to decide a case without a jury trial. Judges also have broad power to limit and exclude the testimony of expert witnesses. Unfortunately, having the power to exclude expert testimony is one thing; exercising it sensibly has proven to be extraordinarily difficult.

Antitrust Policy and the Rehnquist Court

The problem of well-articulated principles but poorly designed rules is severe because in the short run rules weigh much more heavily than principles. Judges do not rewrite antitrust ideology in every case, or even in every decade. Most of the time it matters little what the judge or anyone else thinks about the likelihood and social cost of strategic behavior. To be sure, the rules that courts develop are related to the values they believe antitrust should further. If we think copyrights are packed with anticompetitive potential, then we might respond with a rule that presumes that their owners are monopolists. Several decisions have done just that.[4] But rules generally perform a much subtler function. They reflect concerns about the competencies of courts as much as our substantive concerns about whether and when firms do anticompetitive things. For example, the rules governing expert testimony and summary judgment have to be applied in nearly every significant antitrust case.

The rules problem has been exacerbated by a reduction in the Supreme Court's supervisory role and by a growing amount of conflict among the lower federal courts. In theory, federal antitrust law is unitary. The federal district courts make law at the trial level. Their decisions are reviewed by the Circuit Courts of Appeal, and the fact that most appellate review is mandatory means there is fairly close intracircuit consistency in antitrust law making. The United States Supreme Court sits on top of the circuits, and its traditional role has been to supervise their work and resolve conflicts. The potential for conflict is substantial because there are thirteen federal circuits deciding antitrust cases. These include the First through Eleventh Circuits, plus the D.C. Circuit and the Federal Circuit, which decides patent cases, some of which contain antitrust issues.[5]

One of the remarkable phenomena of the Rehnquist Supreme Court is the degree to which it has denied review in antitrust cases, leaving conflicts to simmer and not correcting clear errors. Robert Bork's *The Antitrust Paradox,* written in 1978, was aimed entirely at the United States

Supreme Court, because at that time that court made virtually all of the important antitrust law. But today the task of making antitrust rules largely befalls the federal courts of appeals, which typically decide between fifty and eighty important antitrust cases per year, very few of which are reviewed by the Supreme Court. This is a significant number, although splits in the circuits tend to reduce their authoritativeness.

The decline in Supreme Court antitrust supervision is partly a consequence of the dramatically reduced docket of the Rehnquist Court from its recent predecessors. In its later years the Rehnquist Court issued a little over half as many decisions per year as the Burger Court (1969–1986) did.[6] Correspondingly, the number of granted petitions for review has declined from approximately 20 percent just after World War II to roughly 2–3 percent today. One explanation for the reduction is that the Court intentionally set out to take fewer cases so that it could write "bigger" decisions—making up for reduced numbers by increased breadth or importance. If that was the strategy it has largely failed. The Rehnquist Court has also been ideologically divided and, perhaps because each Justice is assigned fewer opinions, the number of concurring and dissenting opinions has increased significantly. Instead of speaking more decisively, the Court has often simply generated more confusion by issuing decisions that reveal deep divisions among the Justices.

A review of the Supreme Court workload discloses that the number of reviewed cases in the area of antitrust has declined dramatically. For example, if one compares the 1983–1985 terms, during the tail end of the Burger Court, to the 1993–1995 terms, the number of antitrust cases declined from eleven to one.[7] The Supreme Court issued one antitrust decision per year in 1996, 1997, 1998, and 1999. It issued none in 1995, 2000, 2001, 2002, and 2003. The result is an increasingly balkanized antitrust policy dominated by the circuit courts, even though we nominally have a single set of statutes that cover the entire United States. The Court issued three decisions in 2004, and will issue at least three in 2005. This is a welcome upturn that we hope will continue into subsequent years.

Coupled with this decline in annual antitrust review is the Supreme Court's repeated warning that the lower courts should not anticipate that the Supreme Court will reverse an outmoded precedent, but must let the Supreme Court perform that task for itself.[8] Outmoded and simply bad rules tend to "cling" because the Supreme Court does nothing

about them and the lower courts are helpless to make the changes themselves.

Clear Goals but Deficient Rules

Antitrust is a more defensible enterprise today than it was three and four decades ago, when the Supreme Court produced decisions that were calculated to benefit small business at the expense of consumers. Antitrust has not merely moved to the right, as the federal judiciary has in general. It has also become more coherent, more identifiable with a single economic model, and more trusting of the market to solve most competitive problems. Part of the credit for this lies with a federal judiciary that became increasingly sophisticated about economics in the 1980s and 1990s. Part of it lies also in the scholarship of the "Chicago School" and the more centrist "Harvard School" of antitrust. While these two schools of antitrust thought have diverse origins and historically diverse ideas about the complexity of the economy and the appropriate role of government, they have also converged on a number of important points.

Antitrust is a far humbler enterprise today than it was several decades ago. Those administering the antitrust laws are generally more aware that antitrust is a form of regulation—a type of market intervention in an economy whose nucleus is private markets. Furthermore, intervention is the exception rather than the rule. Market intervention must be justified and the justifications by and large are not moral ones. Punishing unfair behavior is not antitrust's role. Its purpose is to make markets perform more competitively, and intervention is justified only when it moves us toward that goal.

Administrability is key because antitrust is a justifiable enterprise only if court intervention can make markets work better. The sad fact is that economists are often convinced that a certain practice can be anticompetitive, at least part of the time. However, antitrust is forced to leave the practice alone because it has not developed rules that can reliably distinguish anticompetitive results or remedy them effectively.

By appreciating its own limitations antitrust today produces fewer "false positives," or instances when courts condemn predominantly procompetitive behavior. In the process it also produces more false negatives, or situations where it declines to remedy behavior that is very likely anticompetitive. Ironically, part of the problem of false negatives

lies with the very aggressiveness of the antitrust laws themselves, which provide for attorneys' fees and treble damages, and broadly pronounce that "any person" who is injured by an antitrust violation may sue. The result of these broad provisions is a natural attempt by lawyers to turn every conceivable tort and contract dispute into an antitrust action, on a wide range of marginal or even outlandish theories. The equally natural reaction of the federal courts is to trim private antitrust enforcement with rules that narrow the scope of liability, make individual elements of a violation more difficult to prove, and narrow the range of plaintiffs who can sue.

As a historical matter, we probably would have been better off with a less aggressive set of antitrust prohibitions accompanied by a set of procedural and substantive rules that make violations easier to prove. For example, concerns about the excesses of treble damages suits produced the highly underdeterrent indirect purchaser rule considered in Chapter 3. The result is that many firms that have committed antitrust violations never pay a penalty sufficient to deter their conduct. Likewise, concerns about jury speculation and the willingness of courts in the mid-eighties and earlier to infer conspiracies from circumstantial evidence have led to harsh rules that fail to detect many harmful agreements among competitors.

Perhaps most seriously, it has become something of a commonplace that rule of reason antitrust violations are almost impossible to prove, particularly in private plaintiff actions. The rule of reason inquiry remains undisciplined—a problem that the Supreme Court only exacerbated by its 1999 *California Dental* decision, discussed in Chapter 6. Unfocused explorations of restraints generally turn up something that appears beneficial; and as long as plaintiffs have the burden of proof, complexity favors defendants. But rational administration of the antitrust laws requires more focused inquiries and a hard look for less anticompetitive alternatives when a restraint seems both competitively harmful and not essential to the socially beneficial functioning of a joint enterprise.

Not all the errors remaining in the antitrust enterprise are false negatives. Plaintiffs' lawyers continue to push the envelope in their presentation of expert testimony, often crossing the line into "junk" science. The screening rules developed by the Supreme Court have provided only a partial, highly imperfect repair. A great part of the difficulty lies with a

system that regards technical expert testimony as a "question of fact," which means that it falls within the province of the jury. But questions such as whether an expert's multiple regression analysis should have excluded a particular outlying data point, or should have employed more or fewer variables, are "fact" questions only in a highly idiosyncratic sense. Nevertheless, too often the judge who feels unqualified to assess the basic rationality of an expert's methodology hands the job off to the one decision maker in the courtroom who is even less qualified than he is, namely the jury. Fundamentally, we take "questions of law" away from the jury because we distrust jurors' ability to engage in technical interpretation of statutes or legal doctrine. Expert testimony is at least as technical and its jargon just as specialized.

Finally, strategic behavior itself poses a problem. In the 1960s and 1970s the Supreme Court and lower court judges were apt to be suspicious of firms and distrustful of markets. They tended to see a large amount of behavior as strategic, and, moreover, to believe that strategic behavior was anticompetitive. Often they did this with insufficient inquiry into power or even the basic rationality of plaintiffs' claims. At the opposite extreme, Bork's *The Antitrust Paradox,* from the perspective of 1978, saw very little room for anticompetitive strategic behavior other than the formation of cartels. He was inclined to see virtually all single-firm actions, vertical practices, and even most horizontal agreements as procompetitive or competitively harmless simply because strategic opportunities seemed to him to be so few.

The so-called "post-Chicago" antitrust of the 1980s and 1990s reclaimed a concern with strategic behavior, put more rigor into its definition, and tried to raise the level of antitrust concern. Nevertheless, the most visible impact of that movement remains the Supreme Court's 1992 *Kodak* decision, which held that a nondominant firm can have antitrust market power vis-à-vis its "locked in" buyers. Chapter 5 argues that *Kodak* has probably been the most useless and harmful antitrust decision of the Rehnquist Court, which typically has not been expansive in its interpretation of the antitrust laws.

The strategic behavior question divides into two subparts: first, does strategic behavior exist that antitrust doctrine has failed to acknowledge? And second, assuming that it does exist, can antitrust do anything about it? The answer, which some keepers of the faith are loathe to hear, is yes to the first, but often no to the second. Anticompetitive

pricing and exclusion strategies may exist far beyond our institutional capacity to identify them accurately and remedy them effectively. As a result we must frequently conclude that although anticompetitive behavior is probably occurring, antitrust can do nothing about it. Creating any test at all for identifying the practice threatens too many false positives and deficient remedies that are more costly than any social benefits they produce.

Antitrust is an economic, not a moral, enterprise. Nor is its goal compensation for competition's victims, albeit the competitive process produces many. Antitrust is a defensible enterprise only if intervention into the market is economically justified. That entails that the market be "bigger" in some sense as a result of intervention—whether "bigger" is measured by higher output, improved quality, lower prices, or more innovation. Furthermore, the increase must be enough to justify the high cost of operating the antitrust machinery.

Lest these conclusions sound too pessimistic, one must remember that antitrust is not the only way that government manages the economy. Rather, antitrust is the residual regulator, filling in the lacunae among other regulatory and property regimes. For example, while at this writing antitrust seems to have been unequal to the task of managing the Microsoft monopoly, other solutions remain and are likely to be more effective. These possibilities are considered in Chapter 12.

This book is organized into three parts. The first considers the institutional enterprise of antitrust, looking at its history and ideology, its tendency to create overly complicated rules, the numerous problems attending private enforcement, and the uses and misuses of experts. Part II then looks at substantive antitrust doctrine as developed in "traditional" markets. Finally, Part III considers the role of the antitrust laws in regulated industries and networks, as well as the intersection between antitrust and the intellectual property laws.