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Antitrust Law and Economics

EDITED BY
KEITH N. HYLTON

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Preface

This collection of chapters on fundamental topics in antitrust was arranged with the goal of presenting the subject in a manner that reflects modern thinking in both the law and the economics of antitrust. That is not an easy task. Antitrust economics has become a very complicated field. It requires specialization, and as a result it is quite difficult to stay abreast of both the law and the modern economic treatments.

Any effort to provide a balance of legal and economic analysis, given the long history of the law and the level of sophistication in modern economic research, will necessarily involve some sacrifice of both approaches. I am not sure it is possible to present a book that offers the combination of everything an antitrust law specialist would like to see, as well as everything an antitrust economist would like to see. But I think it is better to sacrifice a bit from both of the endpoints to produce something that blends the two approaches, which is what this volume attempts to do.

The argument for incorporating economic analysis in any modern discussion of antitrust law is obvious today. American courts use economic reasoning to reach conclusions on the best policies to adopt in antitrust cases. American antitrust litigation relies heavily on the input of experts trained in economics and statistics. It would be educational malpractice to train any law student to practice antitrust without communicating the importance of economic analysis to the student.

In Europe, the importance of economic analysis to antitrust (competition law as it is known in Europe) is even greater than in the US. The European Commission (EC) tries to act as a scientific body on matters of competition law. It employs economists to develop the competition norms that the EC would like to enforce, and relies on economists to determine the soundness of its enforcement actions. Moreover, since the European courts tend to defer to the EC on matters of policy, economists have a much greater pull on the development of law in the EU than in the US. This has provided enormous incentives for European economists to examine industrial organization issues at the heart of competition law cases.

The argument for incorporating a sophisticated legal approach to the analysis of antitrust has become less obvious today. But its importance should not be discounted. Economic analyses of antitrust divorced from serious consideration of the law tend to meander off into issues that are of little relevance to the courts. More importantly, and especially in the

US, judges have to administer antitrust law, not economists. Judges have to craft rules that can be applied consistently and predictably within the courts. Judges have to consider the likelihood that any given rule will be applied erroneously by future courts, and the costs of those mistakes. The rules that have been developed by courts reflect these considerations. In order to apply economics in a manner that will be useful to courts, the analysis has to be guided by a sense of what will work in application. Lawyers tend to have the advantage on this question.

The authors who have contributed to this volume have the great advantage, in my view, of being familiar with both the law and the economics of antitrust. I hope that this effort to synthesize the two approaches to antitrust yields a sum greater than its parts.

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1 The economics of antitrust enforcement

Daniel A. Crane[1]

Antitrust law is only as good as the mechanisms by which it is enforced. Substance and procedure are not distinct bodies, but part of a continuum of legal and institutional rules, practices, and mechanisms working conjunctively to advance consumer welfare and efficiency. It is impossible to understand the substantive rules without understanding the relevant enforcement mechanisms. Judges tend to formulate liability rules with an eye on enforcement mechanisms. For example, judges tend to be skeptical of the ability of lay juries to decide predatory pricing cases, so they formulate deliberately underinclusive liability rules to thin out the number of predation cases reaching trial.[2] Similarly, the Supreme Court has made it hard to plead conspiracy in cartel cases because trial courts have trouble preventing discovery costs from skyrocketing.[3] Evaluating liability rules in a vacuum, without understanding the institutional considerations that motivate judges, might lead to false impressions about the courts' views of the merits of various competitive practices.

Many of the procedural and enforcement rules that apply to antitrust cases were not designed for antitrust, but are general features of civil or criminal law. Sometimes, mismatches occur between procedure's generality and antitrust's specificity. Generic enforcement methods are not always well-suited to the peculiarities of antitrust.

In the US legal system, antitrust enforcement is decentralized and largely uncoordinated. There are two separate federal antitrust enforcement agencies, fifty state attorneys general with enforcement powers, liberal rules for private enforcement, and a treble damages bounty that draws private litigation entrepreneurs into the antitrust litigation market. Antitrust is enforced both civilly and criminally, publicly and privately, prospectively (for injunction) and retrospectively (for damages or other penalties), formally and informally, and administratively and adjudicatively.

Evaluating this crazy quilt of enforcement mechanisms requires defining the goals of antitrust enforcement, which is the subject of the first part of this chapter. The second part asks what forms of public enforcement are best calibrated to achieve these goals. The third part considers two of the leading issues in private enforcement – standing rules and damages.

I. Enforcement goals

The goals of antitrust enforcement are bound up with the goals of antitrust law itself. How antitrust is enforced depends substantially on what antitrust law is intended to achieve. For much of the history of US antitrust law, there was debate and disagreement over antitrust law's goals.[4] The differing views implied widely varying possibilities about the structure of enforcement. Today, there is broad consensus on the goals of antitrust law, which makes possible a broad consensus on the goals and structure of enforcement.

A. Deterrence, compensation, and any others?

The modern consensus among economists and antitrust practitioners is that antitrust law should exist primarily to achieve allocative efficiency and to advance consumer welfare.[5] Although these two goals sometimes conflict when it comes to the specification of liability rules,[6] they are generally in harmony when it comes to antitrust's enforcement goal.[7] Both allocative efficiency and consumer welfare are best served by an enforcement structure that makes the defendant fully internalize the external cost of the violation – the deadweight loss borne by consumers and monopoly transfer from consumers to producers.[8] Such an approach deters anticompetitive behavior by making socially harmful behavior a negative expected value event.

Deterrence is only one of the recognized goals of antitrust enforcement. The Supreme Court has held that compensation of injured parties is an additional goal, although the Court has seemingly made compensation subsidiary to deterrence.[9] From an economic perspective, it is not obvious why compensation should matter at all. Wealth transfers, whether from consumers to producers or from one business to another business, are an external cost of antitrust violations and can decrease social welfare in a variety of subtle ways. However, economic theory cannot predict with great certainty the social welfare consequences of returning overcharges to the victims of the violation. For example, one might think that wealth transfers from consumers to producers would cause a diminution in net social welfare because producers tend to be wealthier than consumers and money begins to bring diminishing marginal utility returns at higher wealth levels. Hence, compensating the consumers would seem to increase social welfare.[10] But the assumption that producers are wealthier than shareholders is far from universalizable. Consider, for example, a cartel among publicly traded yacht manufacturers whose stock is owned in large portion by employees, small investors, and union pension funds. Compensation cannot be justified as a goal of antitrust enforcement on economic terms, although it may have moral or political justifications.

An additional enforcement goal is prevention through *ex ante*, firm-specific control. Instead of discentivizing anticompetitive behavior (as in the deterrence model), the prevention model involves *ex ante* scrutiny of specific commercial practices by identified actors. Merger control is a leading example of where antitrust works primarily on an *ex ante* approval basis. Instead of punishing firms that have entered into anticompetitive mergers or seeking to break them up after the fact, the Hart-Scott-Rodino Act requires firms that plan to merge to file a notification with the enforcement agencies, enabling the agencies to scrutinize the mergers before they occur. An issue that will be discussed further below is whether it would be preferable to rely more on such an administrative model of antitrust rather than on the adjudicative model that seeks to ascertain and punish past bad acts.

Deterrence and *ex ante* control are the two primary economic goals of antitrust enforcement. Most other goals (in addition to compensation, discussed above) cannot be justified on primarily economic terms. Although political considerations sometimes enter into enforcement decisions,[11] such considerations are largely outside of the jurisdiction of economics.

B. Overdeterrence and underdeterrence

In an ideal world, antitrust decision-makers would simply 'aim to get it right' and not worry about whether they were tending more toward over-inclusion or underinclusion. But it is unrealistic to expect that bodies of law are free from systematic tilts toward false positives (erroneous findings of liability) or false negatives (erroneous findings of non-liability). For example, free speech law may be oriented toward false negatives. First Amendment law protects a good deal of speech that has little social value because the costs of disallowing socially useful speech are generally thought to be higher than the costs of protecting socially harmful speech. On the other hand, securities regulation may be oriented toward false positives. Publicly traded companies may be required to disclose more than the optimal amount of information – and pay penalties if they do not – because it is thought that the costs of overdisclosure are less than the costs of underdisclosure.

Whether antitrust should err in the direction of overdeterrence or underdeterrence is a question for both antitrust substance and antitrust procedure. Adjudicatory errors may occur in both directions – false positive and false negative – and at both the liability rule-framing level (through underinclusion or overinclusion) and at enforcement level (through factfinder error). A tendency in one direction in substantive rules can be counteracted by a tendency in the opposite direction in procedural rules. For example, a tendency toward false positives at the substantive level can be counteracted by the framing of procedural rules (such as evidentiary exclusion rules), stringency in the requirements for expert testimony, or heightened burdens of proof, that make a finding of liability less probable.[12]

As noted at the outset, courts tend to frame liability rules in a deliberately underinclusive manner.[13] They also tend to frame stringent procedural rules that weed out before trial all but the strongest antitrust cases. At both the motion to dismiss and summary judgment stages, courts scrutinize the economic plausibility of antitrust claims and dismiss those cases that lack a sufficiently rigorous foundation in economic theory.[14] The use of these procedural screens necessarily strains out some cases that might be found meritorious if allowed to proceed to discovery or trial. Thus, the recent tendency in US antitrust law has been to tilt both the procedural rules and sustentative liability rules toward underinclusion.

There are several possible explanations and justifications for attitudinal tilts toward false negatives in both liability rules and procedural rules. I will suggest three possibilities.

First, the costs of false positives tend to be greater than the costs of false negatives. In an economy characterized by low regulatory entry barriers, a high rate of innovation, and efficient capital markets, privately acquired market power may be fragile and perpetually contestable – which makes the need for antitrust intervention comparatively low. This would suggest that false negatives are likely to cost relatively little. On the other hand, false positives in antitrust cases may impose costly constraints on otherwise well-functioning capital and industrial markets.

Second, courts may err in the direction of false negatives over those facets of the legal system that they control because those aspects of the legal system that they do not control tilt toward false positives. In particular, the false-negative orientation of antitrust's procedural and substantive rules may be explained by judges' beliefs that jurors tend to err in the direction of overinclusion or false positives. This tendency may occur because jurors misunderstand the complex substance of antitrust law and manifest populist bias against large corporations that use cut-throat – although not necessarily exclusionary – competitive tactics.[15] If jury avoidance explains a least a portion of the judiciary's false-negative orientation, one would expect – or hope – to see judges tilting back toward equilibrium in equitable or administrative actions brought by the government, which do not entail juries. In fact, we observe relatively little difference in judicial attitude toward public and private antitrust cases.[16]

Finally, contemporary judges may be tilting toward false negatives in reaction to a history of perceived error in the opposite direction. The Chicago School critique of the interventionist antitrust precedents of the Warren Court and earlier eras has exerted a profound influence on the courts. Judicial pendulums sometimes swing to the opposite extreme before coming to rest in the middle. Antitrust enforcement may presently be biased toward underinclusion simply because it was formerly biased toward overinclusion.

II. Public enforcement

US public enforcement is comparatively decentralized. Two different federal departments or agencies enforce federal antitrust law, as do each state's attorney general. The Sherman Act is enforced both criminally and civilly. On the civil side, the Justice Department can seek both civil penalties and injunctions, and the injunctions may be simple or complex. These various enforcement mechanisms interact in complex ways.

A. Executive or agency

Both the Antitrust Division of the Department of Justice (and the regional United States Attorneys offices, which are subsets of the Justice Department) and the Federal Trade Commission (FTC) enforce the antitrust laws. The Justice Department and FTC enjoy concurrent enforcement authority over some statutes and exclusive authority over others.[17] However, the two agencies effectively exercise co-extensive authority over all antitrust (with the exception of criminal enforcement, which is the exclusive prerogative of the Justice Department).

In theory, one might justify the existence of two federal agencies on the grounds of comparative advantage over different kinds of matters. The FTC is set up to be politically independent and technocratic. It enjoys rule-making powers and can try matters before specialized administrative law judges, rather than generalist Article III judges. Power is dispersed among five commissioners, no more than three of whom can be of the same political party. By contrast, the Department of Justice enjoys the advantages of unitary executive control, which can accelerate and streamline decision-making.

Unfortunately, there is very little correspondence between the agencies' comparative advantages based on institutional structure and their division of labor.[18] For example, in 2002 the Antitrust Division and the FTC entered into a formal clearance agreement in order to avoid duplication of investigations.[19] The agreement divided antitrust enforcement responsibility based on the agencies' comparative expertise and experience with different industry sectors, not the institutional structure of the agencies. Thus, for example, the FTC was to investigate computer hardware, energy, healthcare, retail stores, pharmaceuticals, and professional services and the Antitrust Division agriculture, computer software, financial services, media and entertainment, telecommunications, and travel.[20] That the Justice Department was to handle computer software while the FTC handled computer hardware had nothing to do with hardware being better suited to the institutional capabilities of the FTC. It was simply a convenient division of labor based on what the two agencies had done in the past. Although the clearance agreement quickly folded due to political pressure from Congress, it exemplifies the essential fungibility of the two agencies.

Not surprisingly, calls have been made to consolidate enforcement in a single agency. For example, this might be accomplished by taking away the FTC's antitrust enforcement powers and leaving it only a consumer protection/anti-fraud mission. Nonetheless, the institutional status quo seems secure for the foreseeable future. Although very few people would draw up the institutional status quo if working on a blank slate, *tabula rasa* design is a very different question from whether to dismantle a system that, whatever its quirks, seems to be working reasonably well.

B. Federal or state

State attorneys general can enforce federal antitrust law in three ways: (1) as 'persons' qualified to seek injunctive relief under Section 16 of the Clayton Act; (2) as persons injured in their business or property when the antitrust violation has harmed the state in its proprietary capacity (*i.e.*, the state government has purchased software from Microsoft); and (3) as *parens patriae* on behalf of their residents.[21] The states attorneys general can also sue in various capacities to enforce their respective state antitrust laws.

State antitrust enforcers have been perceived as being increasingly active in the last two decades, perhaps in response to less aggressive enforcement in Washington. Some commentators have viewed state enforcers through a public choice lens and accused them of pursuing parochial and localist business interests instead of consumer welfare.[22] Others have complained that state enforcers have interfered with federal antitrust enforcement. Richard Posner, who attempted to mediate a settlement in the *Microsoft* case, later complained that the participation of the states made it more difficult to coordinate a settlement and interfered with the federal government's efforts to resolve the matter.[23] Posner has proposed that the federal enforcers should have the authority to preempt state antitrust enforcement in particular cases.[24]

Despite such criticisms, there is no doubt that state enforcement of antitrust law can be a valuable complement to federal enforcement, particularly when it is focused on local market conditions over which the states have a comparative advantage. In recent years, the National Association of Attorneys General (NAAG) has made increasing efforts to coordinate