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In this article we suggest that the U.S. Supreme Court, far from indulging a pro-defendant or anti-antitrust bias, is methodically re-working antitrust doctrine to bring it into alignment with modern economic understanding. Over the last four decades, the Court has increasingly: **(1)** decided antitrust cases in favor of defendants; **(2)** issued antitrust opinions subscribed to by two-thirds or more of the Justices; **(3)** decided antitrust cases in the manner recommended by the Solicitor General; and **(4)** expressly featured economic analysis in its reasoning. There is now broad and non-partisan agreement—in academia, the bar, and the courts—regarding the importance of sound economic analysis in antitrust decision making. We believe this broad consensus has contributed to both the prevalence of supermajority and even unanimous antitrust decisions and to the improved "success rate" of the United States when it appears either as a party or as an amicus in Supreme Court antitrust cases. In addition, because the near-consensus among academic commentators reflects a substantial rethinking of the plaintiff-friendly antitrust decisions of earlier decades, it has led to the present high success rate for defendants.

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I. Introduction

The U.S. Supreme Court decided four antitrust cases during its 2006 Term. Commentators have not failed to notice that the Court favored the defendant in each case, as it has done in every antitrust case for some years. In this article we suggest that the Court, far from indulging a pro-defendant or anti-antitrust bias, is methodically re-working antitrust doctrine to bring it into alignment with modern economic understanding—what some scholars have aptly called "the new learning."[1]

In order to provide more context for the antitrust decisions of the last Term, we reviewed the 117 antitrust decisions that the Court has rendered over the last four decades. These decisions reveal four interesting and, we believe, closely related trends. Over this period, the Court has increasingly:

(1) decided antitrust cases in favor of defendants;

(2) issued antitrust opinions subscribed to by two-thirds or more of the Justices;

(3) decided antitrust cases in the manner recommended by the Solicitor General; and

(4) expressly featured economic analysis in its reasoning.

The last point is perhaps the most significant because it underlies the other three. There is now broad and non-partisan agreement in academia, the bar, and the courts regarding the importance of sound economic analysis in antitrust decision making. We believe this broad consensus has contributed to both the prevalence of supermajority and even unanimous antitrust decisions and to the improved success rate of the United States when it appears either as a party or as an amicus in Supreme Court antitrust cases. In addition, because the near-consensus among academic commentators reflects a substantial rethinking of the plaintiff-friendly antitrust decisions of earlier decades, it has led to the present high win rate for defendants.

> There is now broad and non-partisan agreement in academia, the bar, and the courts regarding the importance of sound economic analysis in antitrust decision making.

In Section II of this article, we discuss the Court's four antitrust opinions from the October 2006 Term with an emphasis on the four themes discussed earlier. In Section III, we analyze the Court's antitrust opinions by decade over the last 40 Terms to assay the origin and strength of these trends.

1 *See* Industrial Concentration: The New Learning (Harvey J. Goldschmid et al., eds., 1974).

II. October Term 2006

The four antitrust cases decided by the Supreme Court during its 2006 Term were *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, *Bell Atlantic Corp. v. Twombly*, *Credit Suisse Securities (USA) LLC v. Billing*, and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* All four were defense wins, three were supported by a supermajority (two-thirds or more) of the participating Justices, three were decided as the Solicitor General recommended, and all four featured from some to a great deal of economic analysis.

A. *WEYERHAEUSER V. ROSS-SIMMONS*

In *Weyerhaeuser*, the plaintiff alleged that defendant Weyerhaeuser had paid excessively high prices for sawlogs, outbidding the plaintiff in order to drive it out of business, in violation of Section 2 of the U.S. Sherman Act.[2] The district court instructed the jury that if Weyerhaeuser paid higher prices than necessary for sawlogs in order to prevent the plaintiff from obtaining the logs it needed at a fair price, then its conduct was indeed anticompetitive. The jury found for the plaintiff, which was awarded more than US$78 million in damages after trebling.

On appeal, Weyerhaeuser argued that the district court should have applied the legal standard for predatory pricing claims set forth in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*[3] Specifically, Weyerhaeuser argued that the jury should have been instructed that the prices it paid were unlawfully high only if those prices resulted in Weyerhaeuser losing money on the sale of processed lumber and Weyerhaeuser had a dangerous probability of recouping those losses after driving the plaintiff out of business. The U.S. Court of Appeals for the Ninth Circuit, however, affirmed the judgment for the plaintiff, noting that the Supreme Court had adopted a particularly high bar for predatory pricing claims in large part because the conduct at issue—low pricing—generally benefits consumers.[4] The Ninth Circuit saw no reason for similar concern with respect to predatory buying claims, and affirmed the district court.

The Supreme Court granted Weyerhaeuser's petition for a writ certiorari, and the United States filed an amicus brief urging the Court to reverse. The United States argued that "[a]ggressive bidding for an input sends important signals to the market, and harm to competition occurs only if the bidder is able to recoup

2 U.S. Sherman Antitrust Act, 15 U.S.C. § 2 (2000 & Supp. IV 2005).

3 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

4 Confederated Tribes of Siletz Indians v. Weyerhaeuser Co., 411 F.3d 1030 (9th Cir. 2005).

any losses."[5] Accordingly, the United States urged the Court to apply the predatory pricing standard of *Brooke Group* to evaluate claims of predatory buying.[6]

The Supreme Court was unanimous in adopting the economic reasoning of the Solicitor General. Justice Thomas noted that predatory buying claims raise the same concerns as predatory pricing claims.[7] Moreover, as the Court explained, "[a] predatory-bidding scheme requires a buyer of inputs to suffer losses today on the chance that it will reap supracompetitive profits in the future. For this reason, 'successful monopsony predation is probably as unlikely as successful monopoly predation.'"[8] Finally, and again in consent with the Solicitor General, the Court explained that high but non-predatory bidding is "often the very essence of competition. Just as sellers use output prices to compete for purchasers, buyers use bid prices to compete for scarce inputs."[9]

The Court's opinion in *Weyerhaeuser* neatly fits all four trends:

(1) it was decided in favor of the defendant;

(2) the opinion was unanimous;

(3) the Court adopted the standard urged by the Solicitor General; and

(4) the opinion relied heavily on economic analysis in general, and in particular, on the new learning in antitrust economics.

B. *BELL ATLANTIC CORP. V. TWOMBLY*

In *Twombly*, class action plaintiffs alleged that, following deregulation of the telephone industry in 1996, the defendant local exchange carriers conspired to inhibit the growth of upstart carriers and refrained from entering one another's historical monopoly territories. Plaintiffs based their claim primarily on the defendants' parallel conduct. That is, they argued that the defendants' parallel course of conduct toward the upstart carriers and the absence of meaningful competition among the defendants in each other's historical territories evidenced a conspiracy to restrain trade, and that plaintiffs were entitled to discovery in order to determine whether the defendants in fact had so conspired.

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5 Brief for the United States as Amicus Curiae Supporting Petitioner at 8, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co. (U.S. Aug. 24, 2006) (No. 05-381).

6 *Id*.

7 *See* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069, 1076 (2007) (citing Roger G. Noll, *"Buyer Power" and Economic Policy*, 72 ANTITRUST L.J. 589, 591 (2005)) ("Asymmetric treatment of monopoly and monopsony has no basis in economic analysis").

8 *Weyerhaeuser,* 127 S. Ct. at 1077 (quoting R. BLAIR & J. HARRISON, MONOPSONY 66 (1993)).

9 *Weyerhaeuser,* 127 S. Ct. at 1077 (quotation omitted).

The district court granted the defendants' motion to dismiss. The court agreed with the defendants that, because parallel conduct by itself does not violate the antitrust laws, plaintiffs must at the pleading stage allege "plus factors" indicative of conspiracy. The U.S. Court of Appeals for the Second Circuit reversed.[10] In a broadly worded opinion, the court relied on the Supreme Court's decision in *Conley v. Gibson* to hold that a case may proceed to discovery unless it is clear that there is no set of facts that might show the "parallelism asserted was the product of collusion rather than coincidence."[11] The court acknowledged the risk that this approach would invite plaintiffs to engage in "fishing expeditions," threatening to impose massive costs on defendants, but stated that if the standard needed changing, then the change would have to come from either the Congress or the Supreme Court.[12] And so it did.

The Supreme Court granted the defendants' petition for a writ of certiorari, and the United States filed an amicus brief urging the Court to reverse. Specifically, the United States argued that a plaintiff must allege facts sufficient to create a "reasonably grounded expectation that discovery will reveal relevant evidence of an illegal agreement."[13] The United States pointed out that "parallel action is a hallmark of competitive markets," and argued that, because the complaint alleged nothing more than parallel conduct and made a conclusory allegation of conspiracy, it fell short of demonstrating a "reasonably grounded expectation" that a conspiracy had taken place.[14]

The Supreme Court agreed. In a 7-2 opinion written by Justice Souter, the Court adopted the standard proposed by the United States, which is that a complaint must include "enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."[15] The Court went on to discuss this standard at length, restating it with slight variations, among them the observation that a viable complaint must "possess enough heft to sho[w] that the pleader is entitled to relief."[16] The Court also made some broad comments regarding practical economic considerations at the pleading stage. For example:

10 Twombly v. Bell Atlantic Corp., 425 F.3d 99 (2d Cir. 2005).

11 *Id.* at 114; Conley v. Gibson, 355 U.S. 41, 47 (1957).

12 *Twombly*, 425 F.3d at 117.

13 Brief for the United States as Amicus Curiae Supporting Petitioner at 8, Bell Atlantic Corp. v. Twombly (U.S. Aug. 25, 2006) (No. 05-1126).

14 *Id.* at 8, 20.

15 Bell Atlantic Corp v. Twombly, 127 S. Ct. 1955, 1965 (2007).

16 *Id.* at 1966.

> "[T]he threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching [the summary judgment stage]. Probably, then, it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no reasonably founded hope that the [discovery] process will reveal relevant evidence to support a § 1 claim."[17]

The Court then dispatched the statement in *Conley* that a case may proceed to discovery unless it "appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief," aptly remarking that "after puzzling the profession for 50 years, this famous observation has earned its retirement."[18]

Finally, applying its newly clarified standard to the facts at hand, the Court concluded: "An allegation of parallel conduct is . . . much like a naked assertion of conspiracy in a § 1 complaint: it gets the complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility of entitlement to relief."[19]

Twombly also fits into all four trends:

(1) it was decided in favor of the defendant;

(2) by a large majority of the Court;

(3) which adopted the standard proposed by the Solicitor General; and

(4) although the opinion dealt more with pleading standards than with substantive antitrust law, the Court did apply economic logic in its discussion of the costs of discovery and in its treatment of the plaintiffs' argument that defendants' parallel inaction was inherently suspicious.

The Court responded to the latter argument with the game-theoretic observation that "a natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same thing."[20]

17 *Id.* at 1967 (quotation omitted).

18 *Id*. at 1969.

19 *Id*. (quotation omitted).

20 *Id.* at 1972.

C. *CREDIT SUISSE FIRST BOSTON LTD. V. BILLING*

In *Credit Suisse*, a putative class of buyers of newly issued securities alleged that the nation's leading underwriting firms had entered into unlawful agreements related to the distribution of securities in initial public offerings (IPOs). Specifically, the plaintiffs claimed the defendants had conspired to manipulate the IPO market by requiring buyers of shares in the IPO to buy additional shares later at escalating prices (i.e., laddering), pay unusually high commissions on subsequent security purchases, and purchase other less-desirable securities (i.e., tying).

The defendants argued that the securities laws and not the antitrust laws governed their conduct, and that only the securities laws could provide a remedy. The district court granted the defendants' motion to dismiss, holding that the securities laws impliedly repealed federal antitrust laws and preempted state antitrust laws as applied to dealings in securities. The district court noted that the Securities and Exchange Commission (SEC) either had expressly permitted or had authority to regulate the various types of conduct being challenged, and therefore application of the antitrust laws might undermine the regulatory scheme.

The Second Circuit reversed, concluding that there was no specific congressional intent, either express or implied, to immunize the challenged conduct.[21] The court rejected the defendants' argument that antitrust immunity is implied by a potential conflict between the antitrust laws and the securities laws, and held that the securities laws were not sufficiently "pervasive" to immunize the defendants' conduct from antitrust liability.[22]

The Supreme Court granted the defendants' petition for a writ of certiorari. In the Second Circuit, the SEC had argued in favor of, and the Antitrust Division of the U.S. Department of Justice (DOJ) had argued against, antitrust immunity for the challenged conduct. In the Supreme Court, the United States filed a single amicus brief suggesting an intermediate position—to withstand a motion to dismiss, a complaint must allege facts giving rise to a "reasonably grounded expectation that the alleged antitrust offense can be established without relying on activities authorized under the regulatory scheme or inextricably intertwined with authorized" (and hence immune) activities.[23]

The Supreme Court reversed. In a 7-1 decision written by Justice Breyer, the Court explained that there is a fine line separating permissible conduct from

21 Billing v. Credit Suisse First Boston Ltd., 426 F.3d 130 (2d Cir. 2005).

22 *Id*.

23 Brief for the United States as Amicus Curiae Supporting Vacatur at 10, Credit Suisse Securities (USA) LLC v. Billing (U.S. Jan. 22, 2007) (No. 05-1157).

impermissible conduct under the securities laws, and some measure of expertise is needed to distinguish between the two.[24] Accordingly, if antitrust suits implicating regulated securities activities were permitted, there would be a high risk of inconsistent results.[25] The Court also built on its earlier opinion in *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP* by holding that the SEC's oversight "makes it somewhat less necessary to rely on antitrust actions to address anticompetitive behavior" in this regulated industry.[26] Finally, the Court, referring to the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998, noted that:

THE COURT EXPLAINED THAT THERE IS A FINE LINE SEPARATING PERMISSIBLE CONDUCT FROM IMPERMISSIBLE CONDUCT UNDER THE SECURITIES LAWS, AND SOME MEASURE OF EXPERTISE IS NEEDED TO DISTINGUISH BETWEEN THE TWO.

> "Congress, in an effort to weed out unmeritorious securities lawsuits, has recently tightened the procedural requirements that plaintiffs must satisfy when they file those suits. To permit an antitrust lawsuit risks circumventing these requirements by permitting plaintiffs to dress what is essentially a securities complaint in antitrust clothing."[27]

Before concluding his opinion, Justice Breyer explicitly noted and rejected the newly crafted position taken by the United States.[28] As the Court explained, the recommendation that the case be remanded for consideration of whether the challenged conduct could be separated from conduct permitted by the regulatory scheme was "in effect, a compromise between the different positions that the SEC and [DOJ] took in the courts below" and simply was not a practical solution in light of the "serious risk that antitrust courts will produce inconsistent results that, in turn, will overly deter" practices authorized by the SEC.[29]

24 *See* Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383, 2395 (2007).

25 *Id*.

26 *Id*. at 2396; Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP, 540 U.S. 398 (2004).

27 *Credit Suisse*, 127 S. Ct. at 2396.

28 *Id*. at 2397.

29 *Id*.

The Court's opinion in *Credit Suisse* fits at least two, and arguably three, of the four trends:

(1) it was decided in favor of the defendant; and

(2) by a large majority.

With respect to trend **(3)**, although the Court did not adopt the position advanced by the Solicitor General, the rejection seems attributable to the unusual circumstances of the case, in which two federal agencies had conflicting views, and in which the resulting amicus brief produced a somewhat strained compromise position. (Indeed, the Justices might well have recalled the adage that a camel is a horse designed by a committee.) With respect to trend **(4)**, while the opinion did not cite any of the new literature on antitrust economics, it did apply basic economic principles in considering the costs of an overinclusive antitrust regime, the incentives facing typical parties, and the possible deterrence of beneficial conduct.

D. *LEEGIN CREATIVE LEATHER PRODUCTS, INC. V. PSKS, INC.*

In *Leegin*, the plaintiff PSKS sold the defendant's brand of fashion accessories at its retail store. Defendant Leegin instituted a "Retail Pricing and Promotion Policy," pursuant to which it established minimum retail prices for its products and later started a marketing initiative granting promotional incentives only to those retail stores that agreed to follow its policy. When the plaintiff put the entire line of Leegin's products on sale below Leegin's authorized minimum prices, Leegin stopped selling to it. PSKS then filed suit under Section 1 of the Sherman Act,[30] claiming that Leegin had entered into unlawful resale price maintenance (RPM) agreements with its retailers.

The district court excluded the proposed testimony of Leegin's economic expert, who would have testified that Leegin's policy was pro-competitive. The district court instructed the jury that vertical minimum price-fixing was illegal per se, and the jury awarded PSKS damages of approximately US$4 million after trebling.

The U.S. Court of Appeals for the Fifth Circuit affirmed.[31] It held that, while the Supreme Court had abandoned the per se rule against various types of vertical restraints, it had never abandoned the per se rule against minimum RPM announced nearly a century before in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[32] Accordingly, the Fifth Circuit held that the district court properly excluded Leegin's expert testimony regarding its pro-competitive rationale for the pricing policy.

30 U.S. Sherman Antitrust Act, 15 U.S.C. § 1 (2000 & Supp. IV 2005).

31 PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 171 Fed. Appx. 464 (5th Cir. 2006).

32 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

The Supreme Court granted defendant's petition for a writ of certiorari, and the United States filed an amicus brief urging the Supreme Court to reverse the Fifth Circuit and abandon the per se rule against minimum RPM. The United States argued that per se rules are the exception rather than the norm in antitrust law, and that minimum RPM did not meet the Court's modern requirements for application of a per se rule.[33]

The Supreme Court agreed. In a 5-4 opinion written by Justice Kennedy, the Court held that "the Court's more recent jurisprudence has rejected the rationales on which *Dr. Miles* was based."[34] Further, the Court noted that the "economics literature is replete with procompetitive justifications for a manufacturer's use of" RPM.[35] Among other things, the Court explained, a "manufacturer's use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers."[36] The Court went on to note, however, that RPM could also be put to anticompetitive use, for example, to implement a cartel among retailers.[37] Finally, the Court considered the doctrine of stare decisis, but found it less compelling in the context of the Sherman Act, which "[f]rom the beginning the Court has treated … as a common-law statute."[38] For all of these reasons, the Court overruled *Dr. Miles* and held that henceforth "[v]ertical price restraints are to be judged according to the rule of reason."[39]

The Court's decision in *Leegin* fits all of the trends but one:

(1) it was decided in favor of the defendant;

(3) as the United States had recommended; and

(4) the opinion relied heavily on economic principles and analysis.

But, with respect to trend **(2)**, this case was not decided by a supermajority—four justices dissented via an opinion written by Justice Breyer.

33 Brief for the United States as Amicus Curiae Supporting Petitioner at 6, 9, Leegin Creative Leather Products, Inc. v. PSKS, Inc. (U.S. Jan. 22, 2007) (No. 06-480).

34 Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2714 (2007).

35 *Id.*

36 *Id.* at 2715.

37 *Id.* at 2717.

38 *Id.* at 2720.

39 *Id.* at 2725.

The principal basis of the dissent, however, was the role of stare decisis, not the merits of the antitrust issue.[40] The dissent went on to say of the merits that even "[w]ere the Court writing on a blank slate" the issue presented would be a difficult one.[41] The concerns the dissent addressed, however, were largely the same ones raised by the majority as relevant considerations under the rule of reason. In sum, it seems clear the case was decided by a much narrower margin than the other antitrust cases of the Term, more because of the Justices' divergent views on stare decisis than any division of opinion on antitrust law.

III. Recent Trends in U.S. Supreme Court Antitrust Cases

In order to understand how the Court's four antitrust decisions from the past Term fit into longer trends in the Court's antitrust jurisprudence, we reviewed the Court's antitrust opinions over the last 40 Terms. By our count, the Court decided 117 antitrust cases during that time. Figure 1, "Antitrust Decisions of the U.S. Supreme Court," provides some basic information related to these cases.

We included cases in Figure 1 if, and only if, they contained one or more holdings related to an antitrust statute, for example, the Sherman Antitrust Act, the Clayton Act, or the Robinson-Patman Act.[42] Thus, for example, we excluded *Intel Corp. v. Advanced Micro Devices, Inc.*[43] Although the underlying facts in that case involved a challenge to competition practices under European law, the issue that reached the Supreme Court involved the authority of federal district courts to assist in the production of evidence for use in a foreign proceeding, and the Court did not offer any guidance with respect to the U.S. antitrust laws.

With respect to amicus briefs filed by the United States, we listed "None" if the Solicitor General did not file a brief in a case and "N/A" if the United States was a party to the case. For a few of the earliest cases, we could not determine conclusively that the Solicitor General did not file a brief; we marked these "None*." In a few cases, we had to make a judgment as to which party was favored by the Solicitor General's amicus brief. For instance, in *Credit Suisse*, the

40 *Leegin*, 127 S. Ct. at 2725-26 (Breyer, J. dissenting).

41 *Id*. at 2726-2727 (Breyer, J. dissenting) (citing, inter alia, 8 P. Areeda & H. Hovenkamp, Antitrust Law ¶¶ 1628-33 (2d ed. 2004); F. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135 (1984); R. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6 (1981); Brief for William S. Comanor and Frederic M. Scherer as Amici Curiae in Support of Neither Party, Leegin Creative Leather Products, Inc. v. PSKS, Inc. (U.S. Jan. 22, 2007) (No. 06-480)).

42 U.S. Sherman Antitrust Act, 15 U.S.C. §§ 1-27 (2000 & Supp. IV 2005) (inclusive of all three Acts).

43 Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241 (2004).

Figure 1

Antitrust Decisions of the U.S. Supreme Court

Case	(1) Decision Favored	(2) Vote	(3) SG Favored or Represented	(4) Law & Economics Citation
Period: OT 1997-2006				**77%**
Bush Administration				
Leegin Creative Leather Products v. PSKS, 127 S. Ct. 2705 (2007)	D	5-4	D	Yes
Credit Suisse Securities v. Billing, 127 S. Ct. 2383 (2007)	D	7-1	P	No
Twombly v. Bell Atl., 127 S. Ct. 1955 (2007)	D	7-2	D	Yes
Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007)	D	9-0	D	Yes
Illinois Tool Works, Inc. v. Independent Ink, 547 U.S. 28 (2006)	D	8-0	D	Yes
Texaco Inc. v. Dagher, 547 U.S. 1 (2006)	D	8-0	D	No
Volvo v. Reeder Simco GSM, 546 U.S. 164 (2006)	D	7-2	D	Yes
Empagran v. F. Hoffmann-LaRoche, 542 U.S. 155 (2004)	D	8-0	D	Yes
U.S.P.S. v. Flamingo Ind., 540 U.S. 736 (2004)	D	9-0	N/A	No
Verizon v. Trinko, 540 U.S. 398 (2004)	D	9-0	D	Yes
Clinton Administration				
California Dental Assn v. FTC, 526 U.S. 756 (1999)	D	5-4	N/A	Yes
NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998)	D	9-0	D	Yes
State Oil v. Khan, 522 U.S. 3 (1997)	D	9-0	D	Yes
Period: OT 1987-1996				**78%**
Brown v. Pro Football, Inc., 518 U.S. 231 (1996)	D	8-1	None	Yes
Bush, Sr. Administration				
Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993)	D	9-0	P	Yes
Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993)	D	6-3	None	Yes
Prof. Real Estate Investors v. Columbia Pictures Indus., 508 U.S. 49 (1993)	D	9-0	D	Yes
Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447 (1993)	D	9-0	D	Yes
F.T.C. v. Ticor Title Insurance Co., 504 U.S. 621 (1992)	P	6-3	N/A	No
Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992)	P	6-3	D	Yes
Summit Health Ltd. v. Pinhas, 500 U.S. 322 (1991)	P	5-4	P	No
City of Columbia v. Omni Outdoor Advertising, Inc., 499 U.S. 365 (1991)	D	6-3	None	Yes
Kansas v. Utilicorp United, Inc., 497 U.S. 199 (1990)	D	5-4	D	Yes
Texaco Inc. v. Hasbrouck, 496 U.S. 543 (1990)	P	9-0	D	Yes
Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990)	D	7-2	D	Yes
California v. American Stores, 495 U.S. 271 (1990)	P	9-0	None	Yes
F.T.C. v. Superior Court Trial Lawyers Association, 493 U.S. 411 (1990)	P	7-2	N/A	Yes
Reagan Administration				
California v. ARC America Corp., 490 U.S. 93 (1989)	P	7-0	P	No
Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492 (1988)	P	7-2	P	Yes
Patrick v. Burget, 486 U.S. 94 (1988)	P	8-0	P	No
Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988)	D	7-2	None	Yes
Period: OT 1977-1986				**60%**
324 Liquor Corp. v. Duffy, 479 U.S. 335 (1987)	P	7-2	P	Yes
Cargill, Inc. v. Monfort of Colorado. Inc., 479 U.S. 104 (1986)	D	7-1	D	Yes
F.T.C. v. Indiana Federation of Dentists, 476 U.S. 447 (1986)	P	9-0	N/A	Yes
Matsushita Elec. Industrial Co. v. Zenith Radio, 475 U.S. 574 (1986)	D	5-4	D	Yes
Fisher v. City of Berkeley, 475 U.S. 260 (1986)	D	8-1	None	No
Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985)	P	8-0	None	Yes
Northwest Wholesale Stationers v. Pacific Stationery & Printing, 472 U.S. 284 (1985)	D	7-2	D	No
Southern Motor Carriers Rate Conference, Inc. v. U.S., 471 U.S. 48 (1985)	D	7-2	N/A	Yes
Town Of Hallie v. City of Eau Claire, 471 U.S. 34 (1985)	D	9-0	D	Yes
N.C.A.A. v. Board of Regents of The Univ. of Oklahoma, 468 U.S. 85 (1984)	P	7-2	P	Yes
Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984)	D	5-3	D	Yes
Hoover v. Ronwin, 466 U.S. 558 (1984)	D	4-3	P	Yes
Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984)	D	9-0	D	Yes
Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984)	P	8-0	D	No
Bankamerica Corp. v. United States, 462 U.S. 122 (1983)	D	5-3	N/A	Yes
Falls City Ind., Inc. v. Vanco Beverage, Inc., 460 U.S. 428 (1983)	D	9-0	D	Yes
Jefferson County Pharmaceutical Ass'n v. Abbott Labs, 460 U.S. 150 (1983)	P	5-4	None	No
Associated General Contractors v. Carpenters, 459 U.S. 519 (1983)	D	8-1	D	Yes
NAACP v. Claiborne Hardware, 458 U.S. 886 (1982)	D	8-0	None	No
Blue Shield of Virginia v. McCready, 457 U.S. 465 (1982)	P	5-4	None	No
Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982)	P	4-3	P	Yes
American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp., 456 U.S. 556 (1982)	P	6-3	P	No
Community Communications Co., Inc. v. City of Boulder, 455 U.S. 40 (1982)	P	5-3	None	No
Carter Administration				
Nat'l Gerimedical Hosp. & Gerontology Ctr. v. Blue Cross, 452 U.S. 378 (1981)	P	9-0	P	No
J. Truett Payne Co., Inc. v. Chrysler Motors Corp., 451 U.S. 557 (1981)	P	5-4	None	No
H.A. Artists & Associates, 451 U.S. 704 (1981)	P	5-4	None	Yes
Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980)	P	9-0	None	Yes
California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97 (1980)	P	8-0	P	No
McLain v. Real Estate Board of New Orleans, Inc., 444 U.S. 232 (1980)	P	8-0	P	No
Reiter v. Sonotone Corp., 442 U.S. 330 (1979)	P	8-0	P	Yes
Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979)	D	9-0	D	No
Group Life & Health Ins. Co. v. Royal Drug Co., Inc., 440 U.S. 205 (1979)	P	5-4	P	No

Figure 1 (cont.)

Case	(1) Decision Favored	(2) Vote	(3) SG Favored or Represented	(4) Law & Economics Citation
Carter Administration (continued)				
Great Atlantic & Pacific Tea Co. v. FTC, 440 U.S. 69 (1979)	D	6-2	N/A	No
St. Paul Fire & Marine Insurance Co. v. Barry, 438 U.S. 531 (1978)	P	6-2	P	Yes
U.S. v. United States Gypsum Co., 438 U.S. 422 (1978)	D	6-2	N/A	Yes
Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978)	D	8-0	None	No
Nat'l Society of Professional Engineers v. U.S., 435 U.S. 679 (1978)	P	8-0	N/A	Yes
City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978)	P	5-4	P	Yes
Pfizer, Inc. v. Government of India, 434 U.S. 308 (1978)	P	5-3	P	No
Bates v. State Bar of Arizona, 433 U.S. 350 (1977)	P	9-0	D	Yes
Continental T.V., Inc., v. GTE Sylvania Inc., 433 U.S. 36 (1977)	D	7-2	None	Yes
Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977)	D	6-3	P	Yes
Period: OT 1967-1976				**30%**
Nixon-Ford Administration				
United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977)	D	9-0	None	Yes
Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977)	D	9-0	None	Yes
Cantor v. Detroit Edison Co., 428 U.S. 579 (1976)	P	6-3	P	Yes
Gordon v. New York Stock Exchange, Inc., 422 U.S. 659 (1975)	D	9-0	P	No
United States v. Nat'l Ass'n of Sec. Dealers, Inc., 422 U.S. 694 (1975)	D	5-4	N/A	No
U.S. v. American Building Maint. Ind., 422 U.S. 271 (1975)	D	6-3	N/A	No
United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86 (1975)	D	6-3	N/A	Yes
Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975)	P	8-0	P	No
Connell Construction Co. v. Plumbers, 421 U.S. 616 (1975)	P	5-4	D	No
Gulf Oil Corp. v. Copp Paving Co., Inc., 419 U.S. 186 (1974)	D	7-2	P	No
U.S. v. Marine BanCorp., 418 U.S. 602 (1974)	D	5-3	N/A	Yes
U.S. v. General Dynamics Corp., 415 U.S. 486 (1974)	D	5-4	N/A	Yes
U.S. v. Falstaff Brewing Corp., 410 U.S. 526 (1973)	D	5-2	N/A	No
Otter Tail Power Co. v. U.S., 410 U.S. 366 (1973)	P	5-2	N/A	No
Hughes Tool Co. v. Trans World Airlines, Inc., 409 U.S. 363 (1973)	D	6-2	P	No
Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 (1973)	P	5-4	D	No
Flood v. Kuhn, 407 U.S. 258 (1972)	D	5-3	None	Yes
Ford Motor Co. v. United States, 405 U.S. 562 (1972)	D	5-2	N/A	Yes
U.S. v. Topco Assocs., 405 U.S. 596 (1972)	P	6-1	N/A	Yes
U.S. v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971)	P	9-0	N/A	No
United Mine Workers of America v. Railing, 401 U.S. 486 (1971)	D	7-2	None	No
Ramsey v. United Mine Workers of America, 401 U.S. 302 (1971)	P	5-4	None	No
Zenith Radio Corp v. Hazeltine Research, 401 U.S. 321 (1971)	P	9-0	None	Yes
U.S. v. Phillipsburg, 399 US 350 (1970)	P	6-1	N/A	No
Perkins v. Standard Oil Co. of California, 399 U.S. 222 (1970)	P	8-0	None*	No
Simpson v Union Oil Co. of California, 396 U.S. 13 (1969)	P	9-0	None	No
Johnson Administration				
Perkins v. Standard Oil Co. of Cal., 395 U.S. 642 (1969)	P	6-2	None	No
Utah Public Service Commission v. El Paso Natural Gas Co., 395 U.S. 464 (1969)	P	5-2	D	No
Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969)	P	9-0	P	No
Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc., 394 U.S. 700 (1969)	P	6-3	None	No
Fortner Enterprises, Inc. v. U.S. Steel Corp., 394 U.S. 495 (1969)	P	5-4	None	Yes
Citizen Pub. Co. v. U.S., 394 U.S. 131 (1969)	P	7-1	N/A	No
U.S. v. Container Corp. of America, 393 U.S. 333 (1969)	P	6-3	N/A	No
U. S. v. Concentrated Phosphate Export Ass'n, 393 U.S. 199 (1968)	P	6-2	N/A	No
Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968)	P	7-1	None	Yes
Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134 (1968)	P	7-2	None	No
First Nat. Bank of Ariz. v. Cities Service Co., 391 U.S. 253 (1968)	D	5-3	None	No
American Federation of Musicians v. Carroll, 391 U.S. 99 (1968)	D	5-2	None*	No
F.T.C. v. Fred Meyer, Inc., 390 U.S. 341 (1968)	P	6-2	N/A	No
Federal Maritime Commission v. Swedish Am. Line, 390 U.S. 238 (1968)	P	8-0	N/A	No
Albrecht v. Herald Co., 390 U.S. 145 (1968)	P	7-2	None	Yes
U.S. v. Third Nat. Bank in Nashville, 390 U.S. 171 (1968)	P	7-0	N/A	No
Case-Swayne Co. v. Sunkist Growers, Inc., 389 U.S. 384 (1967)	P	8-1	None*	No
Burke v. Ford, 389 U.S. 320 (1967)	P	9-0	None	No

Key

P = Plaintiff

D = Defendant

N/A = United States was a party to the case.

None = SG did not file a brief in the case.

None* = Unable to confirm whether SG participated and assumed no participation.

United States styled its brief as "supporting vacatur," but we treat the brief as supporting the plaintiffs because it called for some liability under the antitrust laws, whereas the defendants sought complete immunity therefrom.

In listing the party favored by the Supreme Court, we focused solely on antitrust issues and disregarded issues arising under other laws. In some cases we had to make a judgment in tallying the vote count or as to which party the Court's opinion favored. For instance, *Hartford Fire Insurance Co. v. California* involved a multitude of issues and a fractured decision. Among other things, the Court held that domestic defendants were exempt from the antitrust laws by virtue of the McCarran-Ferguson Act, but that principles of comity did not bar U.S. courts from exercising jurisdiction over the foreign defendants.[44] We treat this as a 9-0 decision favoring the defendants.

In the "Law & Economics Citation" column, we used a handful of rough proxies for the new learning in antitrust economics. In particular, we searched for citations to the writings of Phillip Areeda, Robert Bork, Richard Posner, and Ward Bowman. We also searched generally for citations to economic journals, law reviews, and other academic literature connected with the economics-influenced trend in modern antitrust analysis. Where one or more of these proxies appeared, we listed the decision as involving a "Law & Economics Citation."

Finally, we should note some other important limitations of Figure 1. First, it does not reflect the nature of the question presented in each case. As a result, each case counts as one entry even though this obviously understates the importance of some decisions and overstates the importance of others. In addition, the figure focuses only on the Supreme Court's treatment of antitrust cases at the merits stage. Other interesting observations might be made if the analysis were extended to the Court's consideration of petitions for certiorari in antitrust cases, including those cases that the Court ultimately declined to review.

With these points in mind, we discuss the Court's decisions over the last 40 Terms with respect to:

(1) the defendants' win ratio;

(2) the degree of agreement among the Justices;

(3) the success of the Solicitor General, both as an amicus and when representing the United States as a party; and

(4) the Court's reliance on the law and economics literature.

44 Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993).

A. DEFENSE WIN RATIO

Figure 2, "Party and Solicitor General Success," depicts the performance of plaintiffs, defendants, and the Solicitor General (whether appearing as an amicus or on behalf of the United States as a party) over the past 40 years. As this Figure shows, the win ratio for defendants has improved quite substantially with every passing decade over the past 40 years. During the decade beginning with October Term 1967, the defendant won 16 of 44 (36 percent) of all antitrust cases decided by the Supreme Court. During the decade beginning with October Term 1977, the defendant won 19 of the 42 antitrust cases, or 45 percent of all such cases. In the decade beginning with October Term 1987, the defendant won 9 of the 18 antitrust cases, or 50 percent of the cases. And during the most recent decade, the defendant won all 13 cases, that is, 100 percent.

B. SOLICITOR GENERAL WIN RATIO

Figure 2 also shows that like the Court itself, the Solicitor General's amicus briefs tended to favor antitrust plaintiffs much more frequently 40 years ago than they do today.[45] During the decade beginning with October Term 1967, the Solicitor General supported the defendant in only 33 percent of the cases (3 of 9) in which the United States filed an amicus brief. During the next decade, the Solicitor General supported the defendant in 44 percent of the cases (11 of 25) in which the United States filed an amicus brief. During the decade beginning with October Term 1987, the Solicitor General supported the defendant in 55 percent of the cases (6 of 11) in which the United States filed an amicus brief. And, in the decade beginning in 1997, the United States supported the defendant in 91 percent of the cases (10 of 11) in which it filed an amicus brief.

This trend is less smooth than the one discussed in the prior section. There is a modest increase in pro-defense positions over three decades, followed by a dramatic increase in pro-defense positions in the last decade. Again, the direction of the change does not correlate with changes in the political party of the U.S. Presidential Administration. The Solicitor General filed an amicus brief supporting the defendant in 45 percent of the cases in which he filed an amicus brief under President Reagan, 60 percent of those cases under President George H.W. Bush, 67 percent of the time under President Clinton, and 80 percent of the time under President George W. Bush**.** The substantial (and increasing) support for antitrust defendants across the previous four administrations contrasts sharply with the tepid support for antitrust defendants across the three preceding administrations—14 percent under President Carter, 11 percent under Presidents

45 In addition, the United States has filed amicus briefs in an increasing percentage of the private antitrust cases in the Supreme Court. The United States went from filing amicus briefs in 33 percent of private antitrust cases in the decade beginning with the October Term 1967, to filing amicus briefs in 69 percent of such cases in each of the next two decades and 100 percent in the past decade. *See* Figure 2.

Figure 2

Party and U.S. Solicitor General Success

Party	Party won	Party won / total suits	SG appeared as amicus for	SG appeared as amicus for / total SG appearances as amicus	SG won as amicus for	SG won as amicus for / SG appearances as amicus for	SG appeared as counsel for	SG won as counsel for	SG appeared as amicus for + SG appeared as counsel for / total SG appearances as amicus + total SG appearances as counsel	SG won as amicus for + SG won as counsel for / SG appeared as amicus for + SG appeared as counsel for
Period: OT 1997-2006										
Plaintiff	0	0%	1	9%	0	0%	1	0	15%	0%
Defendant	13	100%	10	91%	10	100%	1	1	85%	100%
Total	13		11		10	91%	2	1	100%	85%
Total private suits: 11		Total SG appearances as amicus / total private suits: 100%								
Period: OT 1987-1996										
Plaintiff	9	50%	5	45%	4	80%	2	2	54%	86%
Defendant	9	50%	6	55%	4	67%	0	0	46%	67%
Total	18		11		8	73%	2	2	100%	77%
Total private suits: 16		Total SG appearances as amicus / total private suits: 69%								
Period: OT 1977-1986										
Plaintiff	23	55%	14	56%	12	86%	6	2	65%	70%
Defendant	19	45%	11	44%	9	82%	0	0	35%	82%
Total	42		25		21	84%	6	2	100%	74%
Total private suits: 36		Total SG appearances as amicus / total private suits: 69%								
Period: OT 1967-1976										
Plaintiff	28	64%	6	67%	3	50%	17	10	88%	57%
Defendant	16	36%	3	33%	0	0%	0	0	12%	0%
Total	44		9		3	33%	17	10	100%	50%
Total private suits: 27		Total SG appearances as amicus / total private suits: 33%								

Nixon and Ford, and 13 percent under President Johnson as illustrated in Figure 3, "Solicitor General Position by U.S. Presidential Administration."

With the Court and the United States moving in the same (generally pro-defendant) direction, it is not surprising that the Court and the United States are increasingly in agreement. In measuring agreement we considered only the party favored by the Solicitor General and by the Court, ignoring subtle distinctions that may have existed between the reasoning of the Solicitor General and that of the Court. For example, in *Trinko*, the United States urged the Court to hold in favor of the defendant on the ground that a refusal to deal should be law-

Figure 3

Solicitor General Position by U.S. Presidential Administration

Party	SG appeared as amicus for	SG appeared as amicus for / total SG appearances as amicus	SG appeared as counsel for	SG appeared as amicus for + SG appeared as counsel for / total SG appearances as amicus + total SG appearances as counsel
Bush Administration				
Plaintiff	1	11%	0	10%
Defendant	8	89%	1	90%
Total	9	100%	1	100%
Clinton Administration				
Plaintiff	0	0%	1	33%
Defendant	2	100%	0	67%
Total	2	100%	1	100%
Bush Sr. Administration				
Plaintiff	2	25%	2	40%
Defendant	6	75%	0	60%
Total	8	100%	2	100%
Reagan Administration				
Plaintiff	8	47%	3	55%
Defendant	9	53%	0	45%
Total	17	100%	3	100%
Carter Administration				
Plaintiff	9	82%	3	86%
Defendant	2	18%	0	14%
Total	11	65%	3	100%
Nixon-Ford Administration				
Plaintiff	5	71%	11	89%
Defendant	2	29%	0	11%
Total	7	100%	11	100%
Johnson Administration				
Plaintiff	1	50%	6	88%
Defendant	1	50%	0	13%
Total	2	100%	6	100%

ful unless that refusal made no "business sense."[46] Although the Court did not adopt the "no business sense" standard, it did decide the case in favor of the defendant. Accordingly, we treat this as a "win" for the United States.

46 *See* Brief for the United States as Amicus Curiae Supporting Petitioner at 7-8, Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP (U.S. May 23, 2003) (No. 02-682).

In the decade beginning with October Term 1967, the Court agreed with the Solicitor General in 50 percent of the cases (13 of 26) in which the Solicitor General filed an amicus brief or appeared on behalf of the United States as a party. In the decades beginning with October Terms 1977, 1987, and 1997, respectively, the Court agreed with the Solicitor General by a fairly consistent margin—in 74 percent (23 of 31), 77 percent (10 of 13), and 85 percent (11 of 13) respectively, of such cases as illustrated in Figure 2 earlier.

C. DEGREE OF CONSENSUS AMONG JUSTICES

By several measures, the degree of consensus among the Justices hearing antitrust cases has been increasing over the past four decades. Figure 4, "Consensus Among the Justices." divides their decisions into those decided by a supermajority of two-thirds or more (including unanimity) and those decided by a closer margin. Although the percentage of antitrust cases decided by a supermajority of the Justices has not changed significantly over the past four decades, there is a dramatic shift with respect to the party favored in these decisions—namely, from the plaintiff to the defendant.

Figure 4

Consensus among the Justices

Party	Win	Supermajority* vote for	Close majority vote for	Supermajority* vote for / Total decisions	Close majority vote for / Total decisions
Period: OT 1997-2006					
Plaintiff	0	0	0	0%	0%
Defendant	13	11	2	85%	15%
Total	13	11	2	85%	15%
Period: OT 1987-1996					
Plaintiff	9	8	1	44%	6%
Defendant	9	8	1	44%	6%
Total	18	16	2	89%	11%
Period: OT 1977-1986					
Plaintiff	23	14	9	33%	21%
Defendant	19	15	4	36%	10%
Total	42	29	13	69%	31%
Period: OT 1967-1976					
Plaintiff	28	24	4	55%	9%
Defendant	16	11	5	25%	11%
Total	44	35	9	80%	20%

*Supermajority=2/3 or more

During the decade beginning with October Term 1967, the Court decided 25 percent of all its antitrust cases by a supermajority vote in favor of the defendant. That is, the Court decided 44 antitrust cases; in 11 of them, a supermajority voted in favor of the defendant. Over the following two decades, that percentage rose to 36 percent and then to 44 percent. Finally, in the decade beginning with October Term 1997, the Court decided 85 percent of all its antitrust cases by a supermajority in favor of the defendant. During these same four decades, the percentage of all antitrust cases that the Court decided by a supermajority in favor of the plaintiff fell from 55 percent to zero. We believe that these figures reflect the increasing convergence among the Justices on the economic approach to antitrust law, which—at least in comparison to the previously prevailing approach—tends to favor the defendant.

D. RELIANCE ON "LAW AND ECONOMICS" LITERATURE

Finally, it is apparent that, over time, the Supreme Court's antitrust opinions have increasingly relied on careful analysis informed by modern economic thought. It has been a long path from the era of infamous decisions such as *Albrecht v. Herald Co.* and *Utah Pie Co. v. Continental Baking Co.*,[47] that were heavily criticized by antitrust scholars,[48] to the Court's 5-4 decision in *Leegin* and its unanimous decision in *Weyerhaeuser*, in which the opinions relied heavily on the writings of legal and economic scholars.

As noted earlier, in attempting to measure this trend we used citations to respected commentators, including Phillip Areeda, Ward Bowman, Robert Bork, and Richard Posner, as a proxy for the Court's reliance on economic analysis. This is a very rough measure, and it probably tends to be underinclusive. For instance, the Court's opinion in *Credit Suisse* applies modern economic analysis in its balancing of error costs and its consideration of incentives and possible over-deterrence of beneficial conduct. But, because the Court does not cite to one of our proxies, the decision falls into the "non-economic" group for purposes of this count.

This rough measure shows an increase in the Court's reliance on economic thought over the last four decades. Supreme Court antitrust opinions that cite the new learning increased from 30 percent in the decade beginning with the October Term 1967 to 60 percent in the next decade, and to 78 percent and 77 percent respectively, in the following two decades (see Figure 1).

47 Albrecht v. Herald Co., 390 U.S. 145 (1968) (in which the Court held that maximum RPM is per se unlawful); Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967) (in which the Court held that deteriorating price structure was evidence of unlawfully low prices).

48 *See, e.g.*, Frank H. Easterbrook, *Maximum Price Fixing*, 48 U. Chi. L. Rev. 886 (1981); Ward Bowman, *Restraint of Trade by the Supreme Court: The* Utah Pie *Case*, 77 Yale L.J. 1 (1967).

IV. Conclusion

Over the last four decades, the Supreme Court has increasingly relied on modern economic analysis in its antitrust opinions. We believe that this new learning in antitrust economics underlies the other three trends we have discussed:

(1) defendants' increasing win ratio;

(2) the increasing degree of agreement among the Justices; and

(3) the growing convergence between the positions taken by the Solicitor General and those adopted by the Supreme Court.

Another result of the new learning has been a change in the nature of the dialogue in Supreme Court antitrust cases. Today, as, for example, in *Leegin*, it is not uncommon to see briefs on both sides of a case making arguments based on sophisticated economic literature. In fact, in several recent cases independent economists have filed their own amicus briefs to offer their assistance to the Court. In a few cases, such as *Illinois Tool Works, Inc. v. Independent Ink*, groups of economists have filed amicus briefs taking opposing positions on the question presented.[49] Even in such cases where there is no consensus among economists, there is, nevertheless, virtually universal agreement among antitrust economists and lawyers alike, that the Court should answer questions of antitrust law with reference to economic competition—matters of consumer welfare and economic efficiency—rather than make political judgments about such economically irrelevant matters as the "freedom of traders," or "the desirability of retaining 'local control' over industry and the protection of small businesses."[50]

> TODAY IT IS NOT UNCOMMON TO SEE BRIEFS ON BOTH SIDES OF A CASE MAKING ARGUMENTS BASED ON SOPHISTICATED ECONOMIC LITERATURE.

Armed with the new learning, the Court has revisited and revised many of the significant holdings of earlier eras. There are still some subjects yet to be reconsidered, such as the per se condemnation of tie-in sales, on which a majority cast substantial doubt, but which the Court ultimately upheld for the sake of stare decisis, in *Jefferson Parish Hospital v. Hyde*.[51] For the most part, though, it seems

49 Illinois Tool Works, Inc. v. Independent Ink, 547 U.S. 28 (2006).

50 *Albrecht*, 390 U.S. at 152; Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962).

51 Jefferson Parish Hospital v. Hyde, 466 U.S. 2 (1984).

likely that the Court will increasingly face novel antitrust issues as to which there is no consensus among academic economists, in cases bolstered by sophisticated economic analyses supporting each side.[52] If so, then the propensity of the Court to agree with the Solicitor General, to favor defendants, and to decide antitrust cases by a supermajority, all will be up for grabs.

52 *See, e.g.*, Brief for the United States as Amicus Curiae at 14-15, 3M Co. v. LePage's Inc. (U.S. May 28, 2004) (No. 02-1865) (urging the Court to decline review in part because further study may "provide useful guidance in resolving the proper treatment of bundled rebates"); *see also* Brief for the United States as Amicus Curiae at 11-13, Joblove v. Barr Labs. Inc. (U.S. May 23, 2007) (No. 06-830) (urging the Court to decline review, in part because "[p]atent litigation settlements that include 'reverse payments' . . . implicate complex and conflicting policy considerations" worthy of review in another case with more typical facts).

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The Roberts Court and the Chicago School of Antitrust: The 2006 Term and Beyond

Joshua D. Wright

The U.S. Supreme Court issued four antitrust decisions this Term (the most it has issued since the 1989-1990 Term) and seven cases over the past two years. The antitrust activity level of the Roberts Court thus far has exceeded the single case average of the Court prior to the 2003-2004 Term by a significant margin. What can be said of the Roberts Court's antitrust jurisprudence? This article examines the quartet of Supreme Court decisions issued during the 2006-2007 Term in an attempt to identify and characterize the antitrust philosophy of the Roberts Court. I argue that the Roberts Court decisions embrace the Chicago School of antitrust analysis and predict that the antitrust jurisprudence of this Court will increasingly reflect this influence.

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I. Introduction

The U.S. Supreme Court issued four antitrust decisions this Term (the most it has issued since the 1989-1990 Term) and seven cases over the past two years. The antitrust activity level of the Roberts Court thus far has exceeded the single case average of the Court prior to the 2003-2004 Term by a significant margin.[1] In addition to these decisions, the Roberts Court has requested input from the government in six antitrust cases over the past three years. This flurry of antitrust activity, combined with an apparent willingness to reconsider long-established precedents that conflict with modern antitrust theory, suggests that the Roberts Court will play a relatively significant role in shaping antitrust doctrine for years to come.

What can be said of the Roberts Court's antitrust jurisprudence? This article examines the quartet of Supreme Court decisions issued during the 2006-2007 Term in an attempt to identify and characterize the antitrust philosophy of the Roberts Court. To preview my conclusion, I argue that the Roberts Court is heavily influenced by the Chicago School of antitrust analysis and predict that the antitrust jurisprudence of this Court will increasingly reflect this influence. One might contend that increased or continued adherence to Chicago School principles is not a function of the Court's composition—but rather the inevitable result of what has been a largely uninterrupted march by the Chicago School on antitrust analysis. Despite the fact that Chief Justice Roberts and Justice Alito were presumed to be conservative antitrust thinkers, there was little evidence from their prior judicial output or litigation experience that either would exercise any distinctively "Chicagoan" influence on the Court's jurisprudence.

What does it mean to claim that the Roberts Court's antitrust jurisprudence is "Chicagoan"? Chicago School means many different things to different people in the antitrust community. Chicago School has been used to describe the contributions to economic thought from the University of Chicago in the 1930's and 1940's, the school of antitrust analysis that derived from Aaron Director's teachings at the University of Chicago. The term also, unfortunately, has been used pejoratively to describe reflexively naïve non-interventionist antitrust policy. However, in this article, I employ the term to describe the three pillars of antitrust analysis derived from the University of Chicago's Law and Economics movement led by Aaron Director:

(1) rigorous application of price theory;

(2) commitment to empiricism; and

1 J. Thomas Rosch, A New Direction for Antitrust at the Supreme Court?, Presentation Before the Antitrust Section of the Minnesota Bar (Mar. 1, 2007).

(3) appreciation of the role of error costs on the optimal design of legal rules.[2]

Section II of this article introduces some defining characteristics of the Chicago School of antitrust analysis. Section III summarizes the Roberts Court's antitrust jurisprudence as represented by its 2006-2007 output. Section IV argues that the Roberts Court's antitrust jurisprudence exhibits a distinctively Chicago School approach. Section V concludes with some predictions concerning likely future movements of antitrust doctrine under the Roberts Court.

II. The Chicago School of Antitrust Analysis

Modern antitrust analysis consists of several alternative schools of economic thought. Much of the recent analytical debate on the appropriate form of antitrust analysis has been characterized as a battle between two of these schools—the "Chicago School" and the "Post-Chicago School" approaches. Of course, the field of antitrust analysis is more competitive than the Chicago versus Post-Chicago duopoly might suggest. As discussed below, the Harvard School, often associated with the work of Philip Areeda, Justice Breyer, and Donald Turner, has also made significant contributions to modern antitrust analysis. While the evolution of the Chicago School and Post-Chicago approaches have been marked by divergence of predictions and policy prescriptions, the Chicago and Harvard Schools have arguably experienced significant convergence in many areas. I focus primarily on a comparison of the Chicago and Post-Chicago approaches to antitrust, while noting how the Roberts Court deviates from both Post-Chicago and Harvard School principles throughout. This focus on the Chicago and Post-Chicago elements is largely a function of the convergence between the Chicago and Harvard approaches and my view that the battle between the Chicago and Post-Chicago scholars will likely have the greatest impact on the future of antitrust. References to the Chicago School and Post-Chicago School are made rather loosely in the antitrust community, quite often incorrectly, and frequently with very different intended meanings. Thus, I will begin with a brief description of both schools and their role in antitrust analysis to fix ideas and define some distinguishing characteristics of each.

THIS FOCUS ON THE CHICAGO AND POST-CHICAGO ELEMENTS IS LARGELY A FUNCTION OF THE CONVERGENCE BETWEEN THE CHICAGO AND HARVARD APPROACHES AND MY VIEW THAT THE BATTLE BETWEEN THE CHICAGO AND POST-CHICAGO SCHOLARS WILL LIKELY HAVE THE GREATEST IMPACT ON THE FUTURE OF ANTITRUST.

2 I do not claim that other schools of economic thought are not also associated with these themes. My claim, *infra* Section II.B., is that the Chicago School is uniquely associated with this combination of characteristics.

A. CHICAGO VS. POST-CHICAGO ANTITRUST ANALYSIS

The history of the Chicago School's influence on antitrust analysis has been well-documented.[3] Professors Jonathan Baker and Timothy Bresnahan usefully break the Chicago School's influence on antitrust into two separate components.[4] The first component, "the Chicago School of industrial organization economics," consists of the work in industrial organization economics which aimed, and succeeded, at debunking the structure-performance-conduct paradigm and its hypothesized relationship between market concentration and price or profitability.[5] Especially influential in the dismantling of the structure-conduct-performance hypotheses was UCLA economist Harold Demsetz,[6] whose work was central to exposing the misspecification of this relationship in previous work by Joe Bain and followers, as well as offering efficiency justifications for the observed correlation, which is that firms with large market shares could earn high profits as a result of obtaining efficiencies, exploiting economies of scale, or creating a superior product.[7]

The second component, "the Chicago School of antitrust analysis," primarily (but not exclusively) contributed empirical work in the form of case studies demonstrating that various business practices previously considered manifestly anticompetitive could be explained as efficient and pro-competitive. Perhaps the most well-known contribution of the Chicago School of antitrust was the "single monopoly profit theorem," which posits that only a single monopoly profit is to be had in any vertical chain of distribution. The logic of the theorem is that

3 *See, e.g.,* Richard A. Posner, *The Chicago School of Antitrust*, 127 U. Penn. L. Rev. 925 (1979); Robert H. Bork, The Antitrust Paradox (1978); William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. Econ. Persp. 43 (2000); Edmund W. Kitch, *The Fire of Truth: Remembrance of Law and Economics at Chicago, 1932-70*, 26 J.L. & Econ. 163 (1983); Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. Penn. L. Rev. 1 (1997); William H. Page, *The Chicago School and The Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, 75 Va. L. Rev. 1221 (1989).

4 Jonathan B. Baker & Timothy F. Bresnahan, Economic Evidence in Antitrust: Defining Markets and Measuring Market Power 23-26 (Stanford Law School, Working Paper No. 328, July 2006).

5 *See, e.g.*, Yale Brozen et al., Concentration, Mergers, and Public Policy (1982) (questioning the causal link between market concentration and price and providing alternative, efficiency-based explanations for the correlation); Industrial Concentration: The New Learning (Harvey J. Goldschmid et al. eds., 1974).

6 Professors Demsetz and Armen Alchian are frequently associated with the Chicago School despite the fact that both spent the bulk of their careers at the University of California at Los Angeles (UCLA). As any UCLA economist should note, the antitrust community has allowed the Chicago School to take credit for many of the contributions from UCLA. The contributions of the UCLA economists to antitrust analysis are discussed by former FTC Chairman, and UCLA alumnus, Timothy J. Muris. *See* Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 Geo Mason L. Rev. 1 (2003).

7 Harold Demsetz, *Two Systems of Belief about Monopoly*, *in* Industrial Concentration: The New Learning (Harvey J. Goldschmid et al. eds., 1974). The contributions of Demsetz and other participants in the famous Airlie House Conference are discussed in Timothy J. Muris, *Economics and Antitrust*, 5 Geo Mason L. Rev. 303 (1997).

a firm with monopoly power at one level of distribution would prefer competition at every other level of the supply chain because that will reduce the price of the product to consumers, increase sales, and maximize total profits. The theorem has been applied to monopoly leveraging theories, as well as tying, essential facilities, vertical integration, and vertical restraints.

The basic features of this second component are generally attributable to the work of Aaron Director[8] and others from 1950 to the mid 1970's.[9] A group of eminent antitrust scholars, such as Richard Posner, Robert Bork, and Frank Easterbrook, followed in Director's footsteps, building on these studies and economic analysis, and advocating bright-line presumptions, including per se legality, which reflected the growing consensus that most conduct is efficient most of the time.

This is not to say that the Chicago School's contributions to antitrust economics were completed by the 1970's, nor that they were limited to the ultimate rejection of the structure-conduct-performance paradigm. For example, "Chicago School" industrial organization economists have continued to contribute to our economic understanding of various business practices, despite the fact that developments in industrial organization economics for the past 20 years have relied primarily on game-theoretic modeling techniques. Recent Chicagoan contributions to antitrust economics include work on exclusive dealing,[10] slotting contracts,[11] and vertical restraints theory.[12]

There is little doubt that the influence of the Chicago School on antitrust law and policy has been substantial, particularly in the Supreme Court. Supreme Court decisions such as *Sylvania*, *Khan*, *Trinko*, and *Brooke Group* were influenced

8 *See* The New Palgrave Dictionary of Economics and the Law 227-33, 601-05 (Peter Newman ed., Macmillan Reference 1998); *see also* Sam Peltzman, *Aaron Director's Influence on Antitrust Policy*, 48 J.L. & Econ. 313 (2005).

9 Seminal contributions from the Chicago School literature include, but are not limited to, Robert H. Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. Chi. L. Rev. 157 (1954); Aaron Director & Edward H. Levi, *Law and the Future of Trade Regulation*, 51 Nw. U. L. Rev. 281 (1956) (*reprinted in this issue as* 3(2) Competition Pol'y Int'l 253 (2007)); Ward S. Bowman, *Tying Arrangements and the Leverage Problem*, 67 Yale L.J. 19 (1957); John S. McGee, *Predatory Price Cutting: The Standard Oil (NJ) Case*, 1 J.L. & Econ. 137 (1958); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?* 3 J.L. & Econ. 86 (1960).

10 Howard P. Marvel, *Exclusive Dealing*, 25 J.L & Econ. 1 (1982); Benjamin Klein & Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 74 Antitrust L.J. 473 (2007).

11 Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & Econ. (forthcoming 2007); Joshua D. Wright, *Slotting Contracts and Consumer Welfare*, 74 Antitrust L.J. 439 (2007); Joshua D. Wright, *Antitrust Law and Competition for Distribution,* 23 Yale J. Reg. 169 (2006).

12 Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265 (1988).

by Chicago School thinking, not to mention the development of the 1982 *Horizontal Merger Guidelines* by Assistant Attorney General William Baxter.[13] Indeed, the 1970's and 1980's were marked by a dramatic shift in antitrust policies, a significant reduction in enforcement agency activity, and calls from Chicago School commentators for the use of bright line presumptions,[14] per se legality of vertical restraints,[15] and even repeal of the antitrust laws altogether.[16] Perhaps the Chicago School's most important and visible victory has been the continual narrowing of the per se rule, which, after *Leegin* lifted the prohibition on minimum resale price maintenance, exists only in naked price-fixing cases and, in a weakened form, in tying cases.

The leading alternative to the Chicago School approach is the Post-Chicago School.[17] The Post-Chicago approach challenged the conditions under which Chicago results, such as the single-monopoly-profit theorem, held. Indeed, authors in the Post-Chicago movement were able to produce a series of models in which a monopolist in one market has the incentive to monopolize an adjacent product market.[18] Post-Chicago economists also created a literature focusing on the possibility of vertical foreclosure. This raising rivals' costs strand of literature has become the most influential Post-Chicago contribution, and has provided a theoretical framework for a number of theories exploring the possibility of anticompetitive effects of various exclusionary business practices.[19] For example, such theorems have been produced to demonstrate that it is possible for tying,[20] exclu-

13 Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1977); State Oil Co. v. Khan, 522 U.S. 3 (1997); Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004); Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

14 *See, e.g.*, Frank Easterbrook, *The Limits of Antitrust*, 65 Tex. L. Rev. 1 (1984), *reprinted in* 1(1) Competition Pol'y Int'l 179 (2005).

15 Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6 (1981).

16 *See, e.g.*, D. T. Armentano, Antitrust Policy: The Case for Repeal (1986).

17 On the Post-Chicago approach to antitrust, *see* Jonathan B. Baker, *A Preface to Post-Chicago Antitrust*, *in* Post-Chicago Developments in Antirust Law 60 (Antonio Cucinotta et al. eds., 2002).

18 A seminal paper in this literature is Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 Am. Econ. Rev. 837 (2000).

19 *See* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986).

20 *See, e.g.*, Whinston (2000), *supra* note 18; Dennis Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 Rand. J. Econ. 194 (2002); *see also* Bruce Kobayashi, *Does Economics Provide A Reliable Guide to Regulating Commodity Bundling By Firms? A Survey of the Economic Literature*, 1 J. Competition L. & Econ. 707 (2005) (surveying the bundling literature).

sive dealing,[21] and predatory pricing[22] to generate anticompetitive effects under certain conditions, including an assumed absence of any pro-competitive justifications for the conduct examined.

The Post-Chicago economic framework has had a modest impact on U.S. competition policy. However, the movement towards the rule of reason analysis is consistent with the approach advocated by Post-Chicago thinkers rather than the structural presumptions of legality favored by Chicago School scholars. Perhaps the watershed mark of Post-Chicago analysis is the Supreme Court's decision in *Kodak*, which seemed to open the door, if only for a moment, to Post-Chicago arguments more generally.[23]

The contrast of the Chicago and Post-Chicago Schools often tempts commentators to adopt something resembling the following narrative when describing the history of intellectual antitrust thought:

1. by introducing economic analysis to antitrust, the Chicago School supplanted the pre-Chicago "structural" view that often resulted in condemning business practices without understanding them and exhibited hostility towards market concentration even when such increased concentration was likely to benefit consumers;

2. Post-Chicago economists exposed the myth endorsed by Chicago School proponents that "everything is efficient" by generating models debunking Chicago assertions that various business practices and conduct could never be inefficient or anticompetitive;

3. it follows from (2) that the Chicagoans overshot the mark in arguing for strong presumptions and, at times, per se legality, because they ignored the possibility that various practices might be anticompetitive; and

4. the Post-Chicago literature teaches that economic indeterminacy is the state of play in the industrial organization literature—and that this

21 Eric B. Rasmusen, Mark J. Ramseyer & John Shepard Wiley Jr., *Naked Exclusion*, 81 Am. Econ. Rev. 1137 (1991); Douglas Bernheim & Michael Whinston, *Exclusive Dealing*, 106 J. Pol. Econ. 64 (1998); John Simpson & Abraham Wickelgren, *Naked Exclusion, Efficient Breach, and Downstream Competition*, 97 Am. Econ. Rev. 1305 (forthcoming 2007).

22 Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 Geo. L.J. 2239 (2000). These arguments were endorsed by the Department of Justice in *United States v. AMR Corp*. *See* Brief for the Appellant United States of America, United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003) (No. 01-3202).

23 Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992). In aftermarket "lock-in" cases most closely resembling the Post-Chicago theories in *Kodak*, lower courts have "bent over backwards to construe *Kodak* as narrowly as possible." *See* Herbert Hovenkamp, *The Reckoning of Post-Chicago Antitrust*, *in* Post-Chicago Developments in Antitrust Law 8 (Antonio Cucinotta et al. eds., 2002); *see also* David A.J. Goldfine & Kenneth M. Vorrasi, *The Fall of the* Kodak *Aftermarket Doctrine: Dying A Slow Death in the Lower Courts*, 72 Antitrust L.J. 209 (2004).

> state favors an optimal antitrust policy characterized by a rule of reason analysis without strong presumptions.

There are many problems with this pendulum narrative. As U.S. Federal Trade Commission (FTC) Commissioner William Kovacic has recently argued, this narrative is not an accurate intellectual history of antitrust in the United States because it misses, or minimizes, the contributions of the Harvard School.[24] Kovacic also points out that this narrative overstates the differences between Chicago and Post-Chicago thinking.[25]

Unfortunately, the Chicago/Post-Chicago narrative has also tempted commentators to adopt extreme and misleading descriptions of one camp or the other—but most frequently of the Chicago School. These descriptions often paint the Chicago School as monolithic, ideological, and extreme in its views.[26] It is none of those things. Chicago authors have documented some of the only empirical examples of raising rivals' costs theories,[27] contributed to the theory of collusion,[28] and explored the use of tying and other practices to monopolize adjacent markets.[29] These caricature-like descriptions of the Chicago movement, however, threaten to nonsensically turn "Chicago School" into a pejorative and have no place in a meaningful dialogue about antitrust policy.[30]

The aim of this essay is not to defend the Chicago School from Post-Chicago analysis or vice versa. When articulated without attention to the particulars, the Chicago versus Post-Chicago debate is at best a distraction from important questions that are critical to generating improvements in antitrust policy. Indeed, both schools agree on a number of important substantive issues for antitrust policy. (For example, both Chicago and Post-Chicago camps view economic theory as the only lens through which to analyze antitrust issues to the exclusion of

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24 *See* William Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago-Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1 (2007). Kovacic's primary theme is that the Chicago/Post-Chicago narrative minimizes the contributions of the Harvard School scholars such as Professors Phillip Areeda and Donald Turner as well as Justice Stephen Breyer.

25 A view endorsed by one of the Chicago School's more prominent contributors. *See* Richard A. Posner, *Keynote Address: Vertical Restrictions and "Fragile" Monopoly*, 50 ANTITRUST BULL. 499, 500 (2005).

26 *See* Kovacic (2007), *supra* note 24, at 11 n. 31 (collecting such descriptions).

27 *See* Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The Standard Oil Case*, 39 J.L. & ECON. 1 (1996).

28 George J. Stigler, *The Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

29 Carlton & Waldman (2002), *supra* note 20.

30 Of course, caricatures of the Post-Chicago movement are equally counterproductive, but less frequently observed presumably because of the relative youth of that intellectual movement and because the Chicago School is a more attractive target given the influence it has had on antitrust policy.

THE POINT OF THIS ESSAY IS TO PROVIDE THE BACKGROUND NECESSARY TO IDENTIFY THE CHARACTERISTICS OF THE CHICAGO SCHOOL OF ANTITRUST ANALYSIS AS AN INTELLECTUAL ENDEAVOR.

other political and social goals). Rather, the point of this essay is to provide the background necessary to identify the characteristics of the Chicago School of antitrust analysis as an intellectual endeavor. Those definitions are required to explain my claim that the Roberts Court's antitrust jurisprudence appears to be heavily influenced by Chicago thinking.

B. SOME DEFINING CHARACTERISTICS OF CHICAGO SCHOOL ANTITRUST ANALYSIS

I contend that the following three methodological commitments are distinctively, while perhaps not exclusively, Chicagoan in nature:

(1) rigorous application of price theory;

(2) the centrality of empiricism; and

(3) emphasis on the social cost of legal errors in the design of antitrust rules.

While the first claim probably will not generate any significant dispute, the second, and to a lesser extent, the third, will attract some dissent and warrant greater discussion. Consequently, I spend the bulk of this section arguing that both **(2)** and **(3)** are distinctively Chicagoan, while conceding that the Post-Chicago and Harvard Schools shared some of these values some of the time.

1. Rigorous Application of Price Theory

The first defining characteristic is the rigorous application of economic theory, especially, but not exclusively, neoclassical price theory, to problems of antitrust analysis. Richard Posner stated that the key distinguishing attribute of the Chicago School of antitrust was that it "view[ed] antitrust policy through the lens of price theory."[31] Because I suspect that most commentators will agree that the application of price theory is indeed a distinctive characteristic of the Chicago School of antitrust, I will not expand on this point other than to offer two caveats.

The first caveat is that Chicago's application of price theory does not imply that both the Harvard School and Post-Chicago applications of economic theory to antitrust lacked rigor. Although this criticism has been leveled at the contributions of the Harvard School to industrial organization in the 1950's and 1960's, most criticisms of the Post-Chicago movement have focused on its excessive mathematical complexity and highly stylized models rather than lack of the-

31 Posner (1979), *supra* note 3, at 928; *accord* BORK (1978), *supra* note 3, at 117.

oretical rigor.[32] The primary difference between the Post-Chicago and Chicago Schools with respect to economic theory is likely that the latter rejects game theory as a useful tool for policy analysis, while the former embraces it as its primary weapon. Importantly, one reason that the Chicago School favored price theory is its ability to generate testable implications for the purpose of empirical testing, while game theory has been criticized on the grounds that it produces too many equilibria to be useful.[33]

The second caveat is to recognize that many of the Chicago School's contributions, especially in the area of vertical restraints, do not rely solely upon neoclassical price theory and the model of perfect competition. Several of the key contributions by Chicagoans shed the confines of the neoclassical price theory model of perfect competition in favor of reliance on the new institutional economics and its focus on institutional details and transaction costs. In a series of articles, Professor Alan Meese has correctly noted that strict adherence to the perfect competition model envisioned in neoclassical economics is not consistent with the Chicago explanations of vertical restraints, which depend on the presence of downward sloping demand curves.[34] While noting that this objection is not without some force, I adopt an inclusive view of the philosophical underpinnings of the Chicago School here, which is inclusive of these contributions.

Adherence to neoclassical price theory was no doubt a hallmark characteristic of Chicago analysis—and much progress was made in advancing antitrust analysis with simple application of price theory. However, embracing a one-to-one

32 *See, e.g.*, Posner (1979), *supra* note 3, at 928-29:

> It is still fair to ask why the application of price theory to antitrust should have been a novelty. The answer, I believe, is that in the 1950s and early 1960s, industrial organization, the field of economics that studies monopoly questions, tended to be untheoretical, descriptive, "institutional," and even metaphorical. Casual observations of business behavior, colorful characterizations (such as the term "barrier to entry"), eclectic forays into sociology and psychology, descriptive statistics, and verification by plausibility took the place of the careful definitions and parsimonious logical structure of economic theory. The result was that industrial organization regularly advanced propositions that contradicted economic theory.

33 *See* Bruce H. Kobayashi, *Game Theory and Antitrust, A Post-Mortem*, 5 Geo. Mason L. Rev. 411, 412 (1997) (criticizing the application of game theory in antitrust on the grounds that "game theoretic models of [industrial organization] have not been empirically verified in a meaningful sense"). *See also* David Evans & Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. Chi. L. Rev. 73, 98 (2005) ("it has yet to demonstrate a capacity to produce what we would call identification theorems—useful descriptions of the circumstances determining whether a practice is procompetitive or anticompetitive").

34 *See, e.g.*, Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. Rev. 143 (1997); Alan J. Meese, *Exclusive Dealing, The Theory of the Firm, and Raising Rivals' Costs: Toward a New Synthesis*, 50 Antitrust Bull. 371 (2005); Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 U. Ill. L. Rev. 77; Alan J. Meese, *Market Failure and Non-Standard Contracting: How the Ghost of Perfect Competition Still Haunts Antitrust*, 1 J. Competition L. & Econ. 21 (2005).

correspondence between perfect competition and Chicago would be overly narrow and not capture the contributions of many members of the Chicago movement. Chicago School economists frequently deviated from the confines of the model of perfect competition where such deviation was useful to generate helpful insights about various business practices.[35] In fact, Chicagoans themselves were among the first to criticize reliance on the model of perfect competition as a useful benchmark for antitrust analysis.[36]

2. The Centrality of Empiricism

The second defining feature is the centrality of empiricism to the Chicago antitrust analysis research agenda. This, I realize, is a somewhat more controversial claim. Post-Chicago scholars have frequently argued that it is the Chicagoan views that are without empirical support.[37] Recent empirical surveys of vertical restraints, on the other hand, appear to support the view that these practices are not likely to produce anticompetitive effects and favor a presumption of legality.[38] The question I address here, however, is not whether the predictions of Chicago School models have generated superior predictive power relative to their Post-Chicago counterparts. Rather, my claim is merely that empirical testing is a central feature of the Chicago School analysis.

There is at least one set of generally undisputed empirical contributions from Chicago School economists—the debunking of the purported relationship between concentration and price asserted by proponents of the structure-conduct-performance paradigm.[39] However, even holding aside the contributions of

35 *See, e.g.*, George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1964) (analyzing the economics of information from a search cost perspective whereas search costs would not exist under perfect competition); Telser (1960), *supra* note 9 (analyzing resale price maintenance); Klein & Murphy (1988), *supra* note 12; Benjamin Klein, *Market Power in Aftermarkets*, 17 MANAGERIAL & DECISION ECON. 143 (1996); Klein & Lerner (2007), *supra* note 10 (analyzing the role of exclusive dealing contracts in preventing dealer free-riding).

36 *See* Harold Demsetz, 100 Years of Antitrust: Should We Celebrate?, Brent T. Upson Memorial Lecture, George Mason University School of Law, Law and Economics Center (1991).

37 For example, at a recent antitrust conference at Georgetown University on "Conservative Economic Influence on U.S. Antitrust Policy," the following panel discussions questioning the empirical underpinnings of various assumptions were held: (1) Is the Assumption Valid That Cartels Are Fragile and Temporary - Particularly Because of the Difficulty of Controlling Cheating?; (2) Is It Valid to Assume that Vertical Arrangements (Merger and Distribution) Can Very Rarely Injure Consumer Welfare?; (3) Has the "Free Rider" Explanation for Vertical Arrangements Been Unrealistically Expanded?; and (4) Has Merger Enforcement Been Unduly Influenced by Conservative Economic Analysis: Consider Barriers to Entry and Structural Presumptions? A gambler might wager with some confidence that the answers to these questions were likely: "No; No; Yes; and Yes," respectively.

38 *See* James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., forthcoming).

39 *See* Brozen (1982), *supra* note 5; Demsetz (1974), *supra* note 7.

these "early" Chicagoans, it is clear that the relative weight attached to empirical evidence by later Chicago antitrust scholars was also relatively high.

Perhaps the most striking example of a Chicago School scholar who offered substantial empirical contributions to the antitrust literature was George Stigler. Seminal Chicago School figures Ronald Coase and Harold Demsetz have both noted Stigler's dedication to empiricism with a note of admiration. Coase describes Stigler as moving effortlessly "from the marshaling of high theory to aphorism to detailed statistical analysis, a mingling of treatments which resembles, in this respect, the subtle and colourful Edgeworth. It is by a magic of his own that Stigler arrives at conclusions which are both unexpected and important."[40] Demsetz eloquently elaborates on this theme:

> "Housed in Stigler's mind, neoclassical theory had more than the usual quality of material with which to work. It was coupled with a joy in verification and with a strong work ethic and sense of duty to his profession. Intelligence, insight, wit, and style were evident in his writings. His articles and essays could not be ignored. They provoked readers to think and often to follow his lead. For some readers, they simply provoked. Stigler's passion for evidence gathering is also evident in his work, and he made no secret of it."[41]

Stigler's work lived up to the billing described by these prominent Chicagoan colleagues and displayed an unmistakable passion for empirics. And it is the empirical flavor of his economic analysis that landed Stigler the Nobel Prize in 1982 for his "seminal studies of industrial structures, functioning of markets, and causes and effects of public regulation." Though, in an ironic twist, Stigler was initially rejected by the University of Chicago economics department for being "too empirical." In his 1964 presidential address to the American Economic Association, Stigler announced that the "age of quantification is now full upon us," and noted that this age would be characterized by policy analysis informed by empirical evidence.[42]

40 R.H. Coase, *George J. Stigler*, *in* Essays on Economics and Economists (1994).

41 Harold Demsetz, *George J. Stigler: Midcentury Neoclassicalist with a Passion to Quantify*, 101 J. Pol. Econ. 793 (1993).

42 *See, e.g.*, George J. Stigler, *The Economist and the State*, 55 Am. Econ. Rev. 1, 17 (1965):

> It will become inconceivable that the margin requirements on securities markets will be altered once a year without knowing whether they have even a modest effect. It will become impossible for an import-quota system to evade calculus of gains and costs.... Studies will inevitably and irresistibly enter into the subject of public policy, and we shall develop a body of knowledge essential to intelligent policy formation.

Stigler's body of work in industrial organization, which he often referred to as "microeconomics with evidence," is powerful proof of the centrality of empiricism to his own approach. For example, Stigler offered an early study of the effects of the antitrust laws,[43] an empirical assessment of block booking practices,[44] and a study of the economies of scale[45] introducing the survivorship principle. Perhaps the strongest support for Stigler's dedication to empirical evidence in the development of antitrust policy was his change in position in favor of deconcentration policy in the early 1950's. This change was in response to the state of empirical evidence debunking the consensus views concerning the relationship between concentration and profitability.[46]

The uniquely Stiglerian commitment to empiricism is a noteworthy feature of the Chicago School's contribution to antitrust analysis in its own right, but there are others who demonstrate a similar commitment. For example, the case studies offered by many Chicagoans have played an important role in antitrust policy. Former FTC Chairman Timothy Muris has made special note of Benjamin Klein's case studies emphasizing the role of vertical restraints in facilitating dealer supply of promotional services when performance is difficult to measure.[47]

In sum, the Chicago School of antitrust analysis places a strong emphasis on empiricism, both in the form of statistical analysis and case studies of specific restraints. One might view the Chicago commitment to price theory, and even measured deviations from price theory where useful to explain economic phenomenon, as an extension of the emphasis on empiricism because of the testable implications that follow from its application.

3. Adoption of the Error-Cost Framework

A third defining feature of the Chicago School of antitrust analysis is the emphasis on the relationship between antitrust liability rules, judicial error, and the social costs of those errors. From an economics perspective, it is socially optimal to adopt the rule that minimizes the expected cost of false acquittals, false convictions, and administrative costs. Not surprisingly, the error-cost approach is distinctively Chicagoan because it was pioneered by Judge Frank Easterbrook of the U.S. Court of Appeals for the Seventh Circuit, a prominent Chicagoan.[48]

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43 George J. Stigler, *The Economic Effects of the Antitrust Laws*, 9 J.L. & Econ. 225 (1966).

44 George J. Stigler, United States v. Loew's*: A Note on Block Booking*, 1963 Sup. Ct. Rev. 152 (1963).

45 George J. Stigler, *The Economies of Scale*, 1 J.L. & Econ. 54 (1958).

46 George J. Stigler, The Memoirs of an Unregulated Economist 97-100 (1988).

47 *See* Muris (2003), *supra* note 6, at 17. The seminal article from Klein & Murphy (1988), *supra* note 12, includes a detailed discussion of Coors' use of vertical restraints to solve dealer free-riding problems.

48 Easterbrook (1984), *supra* note 14.

Subsequently, several commentators have adopted this framework as a useful tool for understanding the design of antitrust rules.[49]

The error-cost framework begins with the presumption that the costs of false convictions in the antitrust context are likely to be significantly larger than the costs of false acquittals since judicial errors that wrongly excuse an anticompetitive practice will eventually be undone by competitive forces. On the other hand, judicial errors which wrongly condemn a pro-competitive practice are likely to have significant social costs; as such practices are condemned and not offset by market forces.

The insights of Judge Easterbrook's error-cost framework combined with the application of price theory and sensitivity to the state of empirical evidence can be a powerful tool for improving antitrust policy. For example, David Evans and Jorge Padilla demonstrate that such an approach to tying favors a modified per se legality standard in which tying is deemed pro-competitive unless the plaintiff presents strong evidence that the tie was anticompetitive.[50] Their conclusion is based upon the formulation of prior beliefs concerning the likely competitive effects of tying grounded in an assessment of the empirical evidence evaluating both Chicago and Post-Chicago economic theories. Evans and Padilla label their approach "Neo-Chicago" because it purportedly adds to the conventional Chicago approach to the error-cost framework. To the extent that this label helps to distinguish calls for presumptions of legality informed by decision-theoretic analysis from those who would argue for per se legality based solely on the Chicago School "impossibility theorems," it may be a useful addition to the antitrust nomenclature. However, largely for expositional convenience, and also because it is quite fair to credit Judge Easterbrook's contribution of the error-cost framework to the Chicago School, I will use "Chicago" as synonymous with Evans and Padilla's "Neo-Chicago."

This is not to say that the Chicago School possesses an exclusive claim to placing significant weight on error and administrative costs in the design of antitrust standards. Indeed, FTC Commissioner Kovacic has persuasively demonstrated that the Harvard School has played an integral role in promoting the administrability of antitrust rules, which is a predecessor of the error-cost framework discussed above.[51] Perhaps the most well known proponents of this position are Professors Phillip Areeda and Donald Turner who have consistently argued that

49 *See, e.g.*, Evans & Padilla (2005), *supra* note 33; C. Frederick Beckner III & Steven C. Salop, *Decision Theory and Antitrust Rules*, 67 Antitrust L.J. 41 (1999); Keith N. Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 Antitrust L.J. 469 (2001); Luke Froeb et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 Int'l J. Indus. Org. 639 (2005).

50 Evans & Padilla (2005), *supra* note 33. Others have applied the error-cost framework in a similar manner. *See supra* note 49.

51 *See* Kovacic (2007), *supra* note 24.

antitrust rules should be administrable.[52] The Harvard School's then-Judge Stephen Breyer incorporated the insights of the Harvard approach into antitrust doctrine in *Barry Wright*, noting that "antitrust laws very rarely reject ... 'beneficial birds in hand' for the sake of more speculative ... 'birds in the bush.'"[53] Again, the Harvard School's sensitivity to the possibility of deterring pro-competitive conduct as a result of judicial error is related to the Chicago School's error-cost framework.

To this point, I have argued that the Chicago School of antitrust analysis is properly characterized by these three principles:

(1) application of price theory;

(2) commitment to empiricism; and

(3) appreciation of the implications of the error-cost framework for the design of antitrust rules.

In Section III, I summarize the Roberts Court's 2007 antitrust output before arguing in Section IV that this output exhibits these three distinctive marks of Chicago influence.

III. The Roberts Court's 2006-2007 Antitrust Decisions

The Supreme Court heard four antitrust cases this Term. In relative and historical terms, this is an astonishing level of activity. The Roberts Court's production over the past two Terms, and its apparent comfort with complex antitrust issues, suggests this Court is likely to remain interested and engaged in antitrust, even if not at its current rate of output. In this section, I summarize this output before turning to my central claim.

> THE ROBERTS COURT'S PRODUCTION OVER THE PAST TWO TERMS, AND ITS APPARENT COMFORT WITH COMPLEX ANTITRUST ISSUES, SUGGESTS THIS COURT IS LIKELY TO REMAIN INTERESTED AND ENGAGED IN ANTITRUST, EVEN IF NOT AT ITS CURRENT RATE OF OUTPUT.

A. *LEEGIN CREATIVE LEATHER PRODUCTS, INC. V. PSKS, INC.*[54]

Leegin is a typical resale price maintenance (RPM) case involving a terminated dealer. The plaintiff, PSKS, operated a women's apparel store in Texas. The defendant, Leegin, manufac-

52 PHILLIP AREEDA & DONALD TURNER, ANTITRUST LAW 31-33 (1978).

53 Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983).

54 Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007).

tures and distributes a number of leather goods and accessories including handbags, shoes, and jewelry under the "Brighton" brand name. In 1997, Leegin introduced its RPM program, the "Brighton Retail Pricing and Promotion Policy," a marketing initiative under which it would sell its products exclusively to those retailers who complied with the suggested retail prices. When Leegin learned that PSKS was discounting the Brighton product line below the suggested retail prices, Leegin terminated PSKS and PSKS, in turn, filed suit alleging that Leegin's new marketing and promotion program violated the U.S. Sherman Act. The trial court found Leegin's policy per se illegal under the standard set forth in the Supreme Court's *Dr. Miles* decision.[55] The jury awarded a US$1.2 million verdict which was upheld by the U.S. Court of Appeals for the Fifth Circuit.[56]

Justice Kennedy authored the Supreme Court's majority opinion, reversing the Fifth Circuit. He was joined by Justices Scalia, Thomas, Roberts, and Alito. Justice Kennedy's analysis largely adopted the structure of the argument offered by both the antitrust agencies and a group of economists in amicus briefs filed in support of Leegin, and in favor of overturning *Dr. Miles* and evaluating minimum RPM under a rule of reason standard. Justice Kennedy's majority opinion offers four central points:

(1) per se analysis is reserved for restraints that, echoing the language of *Sylvania*,[57] "always, or almost always, reduce consumer welfare by limiting competition and output;"

(2) economic theory strongly suggests that RPM does not meet that stringent standard;

(3) empirical evidence comports with economic theory on RPM; and

(4) stare decisis rationales for continuation of a per se rule and adhering to *Dr. Miles* are unpersuasive.

The majority launched their attack on *Dr. Miles* with a reminder that the rule of reason, and not per se analysis, is the appropriate default rule for antitrust analysis of any economic restraint, and deviation from this default is warranted only when the restraint is known to be "manifestly anticompetitive"[58] and "would always or almost always tend to restrict competition and decrease output."[59]

55 Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

56 171 F. App'x 464 (5th Cir. 2006) (per curiam).

57 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

58 *Id.* at 49-50.

59 Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988) (quoting Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 289-90 (1985)).

Measured against this standard, and after a review of the theoretical justifications for RPM and the empirical evidence concerning its competitive effects, Justice Kennedy found the case for continued application of the per se rule profoundly lacking. The majority does not limit its discussion of justifications for RPM to the conventional discount dealer free-riding story. Instead it finds the literature "replete with pro-competitive justifications" and notes the consensus on this point amongst economists. Importantly, the majority also recognizes that RPM might be used to encourage retailer services even where inter-dealer free-riding is not possible.[60] While recognizing the potential for RPM to produce anticompetitive effects by facilitating collusion, the majority finds that the empirical literature suggests that efficient uses of RPM are not "infrequent or hypothetical," and therefore that the standard for applying the per se rule has not been satisfied.

In his dissent, Justice Breyer offers an enthusiastic defense of *Dr. Miles*. Unfortunately, the enthusiasm is not warranted and the defense is not supported by evidence or economic theory. While Justice Breyer begins by recognizing the "always or almost always" standard that must be satisfied in order to apply the per se rule (in the absence of overriding stare decisis concerns), his failure to understand the economics of vertical restraints and to recognize the state of empirical evidence are fatal to his argument.

Regarding the empirical effects of RPM, Breyer points to a 30-year-old study that compared retail prices across states after the repeal of the Miller-Tydings Fair Trade Act, which found that retail prices were higher by between 19 and 27 percent,[61] and a statement from an FTC Bureau of Economics Staff Report to the Federal Trade Commission stating that RPM frequently increased retail prices. This evidence obviously is not sufficient to meet the "always or almost always anticompetitive" standard required for applying the per se rule.

However, the empirical evidence also presents a more fundamental flaw that is fatal to Justice Breyer's claim that this evidence is probative of anticompetitive effects—both pro-competitive and anticompetitive theories of RPM predict higher retail prices! The key question here is whether RPM reduces output. A study that looks exclusively at retail prices simply cannot disentangle the anticompetitive theories from those that predict that RPM facilitates dealer promotion and thus effectively shifts the demand curve for marginal consumers. Justice Breyer's failure to recognize this rather pedestrian economic point in his dissent

60 This argument has long been accepted in the economics literature, first introduced *in* Klein & Murphy (1988), *supra* note 12, and later formalized *in* Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57, 74–75 (1998). Until *Leegin*, antitrust legal analysis had focused primarily on the narrow "discount dealer" free-riding introduced *in* Telser (1960), *supra* note 9.

61 As discussed in the Economists Brief and elsewhere, these studies do not control for anything. *See* Brief of Amici Curiae Economists in Support of Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480).

is puzzling when one considers his experience with antitrust arguments, his reputation as a savvy antitrust analyst who almost surely understood the need for an output test, and the fact that this very point was raised in oral argument. Without any proper evidence that RPM resulted in a loss of consumer welfare, or harm to the competitive process, there is simply no plausible economic justification for the per se rule.

The dissent complains that there is no advantage to the Court from following the whims of economists who sometimes disagree with one another (or themselves over time).[62] But the disagreement between economists is over the weight that should be attributed to various explanations of RPM. Of course, there is virtually zero disagreement between economists regarding the real question at issue in *Leegin*, that is, does RPM always, or almost always, reduce output? Neither the petitioners, nor the dissent, offer the name of any economist who answers that question in the affirmative. The silence speaks volumes concerning the consensus on this point.

Justice Breyer also displays a surprising unfamiliarity with the economics of vertical restraints, adopting the argument popularized by Professor Robert Pitofsky that the discount-dealer free-riding justification for RPM is not persuasive and not likely to apply in many settings where we observe RPM.[63] To be sure, the argument that RPM prevents discount dealers from free-riding on promotional investments made by full service retailers, first analyzed by Lester Telser, does not explain the prevalence of RPM in product markets where it is highly unlikely that consumers stop first at the full service retailer and consume services before purchasing the product elsewhere.[64] But the justifications for RPM are not limited to that explanation, as noted in the majority opinion (and by extension, the brief authored by the FTC and the U.S. Department of Justice (DOJ), and the Economists' Brief).[65] A key explanation for the use of RPM is Benjamin Klein and Kevin Murphy's explanation that RPM may be used to enforce efficient contracts involving promotional services or other non-contractible elements of performance.

Breyer's response to the Klein and Murphy promotional services explanation for RPM, like the response to the state of empirical evidence, is puzzling:

62 Justice Breyer, half-joking during oral argument, noted that perhaps "counting heads" of economists should play a role in antitrust analysis.

63 Robert Pitofsky, *Are Retailers Who Offer Discounts Really Knaves? The Coming Challenge to the* Dr. Miles *Rule*, 61 ANTITRUST 63 (Spring 2007).

64 For a discussion of this point, *see* Klein & Lerner (2007), *supra* note 10, at n. 63.

65 Brief for the United States as Amicus Curiae Supporting Petitioner & Brief of Amici Curiae Economists in Support of Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480).

> "The one arguable exception consists of the majority's claim that "even absent free-riding," RPM "may be the most efficient way to expand the manufacturer's market share by inducing the retailer's performance and allowing it to use its own initiative and experience in providing valuable services." I cannot count this as an exception, however, because I do not understand how, in the absence of free-riding (and assuming competitiveness), an established producer would need RPM. Why . . . would a dealer not expand its market share as best that dealer sees fit, obtaining appropriate payment from consumers in the process? There may be an answer to this question. But I have not seen it."[66]

The argument that vertical restraints can facilitate retailer supply of promotion, even in the absence of dealer free-riding, is cited in the majority opinion and explained in the Economists' Brief in a fairly accessible manner. This argument has been well accepted in the economics literature for over 20 years.

Of course, the antitrust enterprise does not turn solely on the view of economists and economic theory.[67] The dissent offers two further defenses of the *Dr. Miles* rule that turn upon principles of stare decisis, and identifying U.S. Congressional intent in passing the Consumer Goods Pricing Act in 1975. The stare decisis defense depends critically on Justice Breyer's assessment that the economic arguments in favor of overturning *Dr. Miles* have not changed "for close to half a century." This is not so. As discussed earlier, this characterization is undermined by the dissent's erroneous interpretation of the empirical evidence concerning RPM and a failure to understand the role of RPM in facilitating the increased supply of promotional services even without inter-dealer free-riding. Further, the Supreme Court has recognized that stare decisis arguments in the antitrust context are unlike conventional statutory analysis because of the nature of Congress's delegation to the courts of the duty to define the broad and undefined language of the Sherman Act. Justice Kennedy acknowledged that the Court was not writing on a "clean slate," but recognized that reevaluation of

66 *Leegin*, 127 S. Ct. at 2733 (Breyer, J. dissenting).

67 Justice Breyer offered this reminder as a circuit court judge in *Barry Wright*, noting that:

> [U]nlike economics, law is an administrative system the effects of which depend on the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.

Barry Wright Corp., 724 F.2d at 234.

precedent is appropriate in the antitrust context when a decision has been called into "serious question," as was clearly the case with *Dr. Miles*.[68]

The dissent next argued that overruling *Dr. Miles* would effectively repeal the Consumer Goods Pricing Act of 1975, that repealed the 1937 Miller-Tydings Act which had allowed states to authorize RPM. The dissent argues that the repeal of the 1937 Act should be interpreted as a statement of Congressional intent to endorse application of the per se rule against RPM. The majority rejected this argument, noting that "the text of the Consumer Goods Pricing Act did not codify the rule of *per se* illegality for vertical price restraints. It rescinded statutory provisions that made them *per se* legal" and, therefore, merely placed RPM once again within the ambit of the Sherman Act.[69]

It remains to be seen what impact *Leegin* will have on antitrust jurisprudence as Congress, presumably along with state legislatures, will likely consider legislation to revive the per se rule of *Dr. Miles*. One possible result will be a patchwork of laws on vertical RPM, which would likely impose significant costs on manufacturers attempting to navigate these standards across state lines.[70] Nonetheless, *Leegin* is not without significant benefits to manufacturers who have had to contract around the prohibition on RPM through more complex arrangements with distributors. Further, the decision reconciles previously incoherent antitrust doctrine with modern economic theory.

B. *BELL ATLANTIC CORP. V. TWOMBLY* [71]

While *Twombly* offered the Court an opportunity to clarify the pleading requirements under Section 1 of the Sherman Act, it has also been viewed as having greater procedural implications outside of the antitrust context for its apparent rejection of notice pleading in favor of a "plausibility pleading."[72] While some commentators have argued that *Twombly* is not likely to become very significant,[73] it undoubtedly alters the Section 1 landscape considerably by increasing

68 *See* State Oil v. Khan, 522 U.S. 3 (1997).

69 *Leegin*, 127 S. Ct. at 2724.

70 *See* Tad Lipsky & Alexi Maltas, Leegin *and the Future of Resale Price Maintenance*, eCCP Case Note (July 2007), *at* http://www.globalcompetitionpolicy.org/index.php?&id=508&action=907 (last visited Oct. 12, 2007).

71 Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955 (2007).

72 *See* A. Benjamin Spencer, Plausibility Pleading (Washington & Lee Legal Studies Paper No. 2007-17, July 30, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003874.

73 *See* Einer Elhuage, *Twombly* – The New Supreme Court Antitrust Conspiracy Case, Volokh Conspiracy Blog (May 21, 2007), *at* http://www.volokh.com/posts/1179785703.shtml (last visited Oct. 12, 2007).

the pleading burden imposed on plaintiffs alleging horizontal conspiracies. Some factual and procedural background is necessary to place the decision in context.

The plaintiff class alleged that four major local exchange carriers—Bell Atlantic, Bell South, Qwest Communications International, and SBC (known as Incumbent Local Exchange Carriers or ILECs)—colluded to block competitive entry by Competitive Local Exchange Carriers (CLECs) pursuant to the framework established by the 1996 Telecommunications Act, which required the incumbent carriers to sell local telephone services at wholesale rates, lease unbundled network services, and permit interconnection. The allegations themselves consisted of claims that the defendants agreed not to enter each other's territories as CLECs and to jointly prevent CLEC entry altogether.

The district court found that these allegations amounted simply to assertions of parallel conduct, and as such, were vulnerable to dismissal pursuant to the defendants' Fed. R. Civ. P. 12(b)(6) motions without allegations of additional "plus factors," such as those required at the summary judgment stage. The Second Circuit reversed unanimously, despite some hesitation and concern regarding the "sometimes colossal expense" of discovery in complex antitrust cases, and held that Fed. R. Civ. P. 8(a) did not require allegations of the "plus factors" required to survive summary judgment.

Justice Souter authored the majority opinion in a 7-2 decision holding that "stating [a Section 1 claim] requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made … [This requirement] simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."[74]

The majority makes clear that allegations of parallel conduct alone are not sufficient to survive the pleading stage, "retiring" and rejecting the "no set of facts" formulation favored by *Conley v. Gibson*, despite the conventional rule disfavoring motions to dismiss in antitrust cases.[75] The Court's rationale for increasing the pleading burden faced by plaintiffs in antitrust conspiracy cases is explicitly motivated by the desire to avoid the extraordinary costs of discovery in such cases unless there is good reason to believe that an agreement will be unearthed.

One lesson from *Twombly* is clear—a conclusory "allegation of parallel conduct [with] a bare assertion of conspiracy" is not sufficient to plead a conspiracy without "a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action."[76] The application of the new plausibility standard to plaintiffs' claims was relatively straightforward as

74 *Twombly*, 127 S. Ct. at 1965.

75 Conley v. Gibson, 355 U.S. 41 (1957).

76 *Twombly*, 127 S. Ct. at 1966.

the allegations consisted of parallel conduct alone and no independent allegation of actual agreement among the ILECs. But it remains to be seen precisely what sort of allegations will be sufficient to survive a motion to dismiss. In one recent case, *In re OSB Litigation*,[77] plaintiffs' Section 1 allegations survived a post-*Twombly* motion to dismiss largely because the complaint described alleged repeated communications between rivals announcing an intention to shut down plants and reduce output, and detailed the mechanism by which the collusive agreement was formed (involving the use of published prices in a trade publication), monitored, and enforced.

The full implications of *Twombly* are yet to be realized. Concerns with false positives in Section 1 cases, and the massive social costs of discovery, clearly motivated the Court's push towards an increased pleading burden for antitrust plaintiffs. An open question remains as to precisely what plus factor allegations will be sufficient, when added to parallel conduct, to survive *Twombly*'s more rigorous standard. One result of *Twombly*, which appears unavoidable, is that the plausibility standard may operate as a Full Employment Act for economists who will now be called in at the pleading stages to declare that market conditions are conducive to coordination or tend to exclude the possibility of independent action.

C. *CREDIT SUISSE SECURITIES (USA) LLC V. BILLING*[78]

In *Credit Suisse*, the Court dismissed a variety of antitrust claims brought by investors against underwriters from whom they had purchased securities. The plaintiff class complained that the collective initial public offering (IPO) underwriting process violated Section 1 of the Sherman Act. Specifically, the investors alleged that investment banks had entered into a conspiracy to drive up the price of less-attractive shares in the aftermarket through the use of tie-ins and so-called "laddering agreements." The investment bank defendants argued that the complaint should be dismissed on the grounds that the federal securities laws impliedly precluded application of the antitrust laws.

The Supreme Court agreed with the investment banks. In a 7-1 decision, Justice Breyer's majority opinion held that the antitrust claims against the investment banks arising from the underwriting transactions were impliedly preempted under a "clear incompatibility" standard in light of:

(1) the Securities and Exchange Commission's (SEC) regulatory authority to supervise these activities;

(2) the fact the SEC has exercised that authority;

77 No. 06-826, 2007 WL 2253418 (E.D. Pa. Aug. 3, 2007).

78 Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383 (2007).

(3) the problems associated with simultaneous application of both the antitrust and securities laws to the underlying conduct in terms of conflicting guidance; and

(4) the fact that the underwriting activities fell "squarely within an area of financial market activity that the securities law seeks to regulate."[79]

The Court concluded that application of the antitrust claims would compromise the securities laws, reasoning that:

> "[W]here conduct at the core of the marketing of new securities is at issue; where securities regulators proceed with great care to distinguish the encouraged and permissible from the forbidden; where the threat of antitrust lawsuits, through error and disincentive, could seriously alter underwriter conduct in undesirable ways, to allow an antitrust lawsuit would threaten serious harm to the efficient functioning of the securities market."[80]

Because of the SEC's activity in this area, and its rules and regulations that prohibited the conduct in question, the Court argued that the benefits of antitrust enforcement were small.

PERHAPS MORE IMPORTANTLY, SOME COMMENTATORS HAVE ARGUED THAT *CREDIT SUISSE* MAY SIGNAL A NARROWING OF THE SCOPE OF ANTITRUST IN REGULATED INDUSTRIES IN FAVOR OF SECTOR REGULATION.

Credit Suisse has important implications for antitrust practice. As a practical matter, *Credit Suisse* avoided introducing the threat of private antitrust litigation and the specter of treble damages against investment banks participating in the underwriting process. Perhaps more importantly, some commentators have argued that *Credit Suisse* may signal a narrowing of the scope of antitrust in regulated industries in favor of sector regulation.[81] It is unclear whether *Credit Suisse* indeed signals a willingness to expand implied

79 *Id.* at 2392. Justice Stevens' concurring opinion would have reached the same result on the alternative grounds that the claims should have been dismissed on the merits. *Id.* at 2398 (Stevens, J. concurring). Justice Thomas' dissenting opinion argued that the savings clauses of the securities laws preserved antitrust remedies for securities purchasers and avoided any need to reconcile the apparent conflict between antitrust and securities law. *Id.* at 2399-2400 (Thomas, J. dissenting). Justice Kennedy did not participate.

80 *Id.* at 2396.

81 *See* Keith Sharfman, Credit Suisse*, Regulatory Immunity, and the Shrinking Scope of Antitrust*, eCCP CASE NOTE (June 2007), *at* http://www.globalcompetitionpolicy.org/index.php?&id=500&action=907 (last visited Oct. 12, 2007) (arguing that the "clearly incompatible" standard threatens to render mere regulatory overlap a sufficient condition for implied immunity from the antitrust laws).

immunity, or whether the logic of *Credit Suisse* will be limited to the specific circumstances involving the regulatory overlap between the SEC and antitrust concerning tying arrangements and laddering agreements.

D. *WEYERHAEUSER CO. V. ROSS-SIMMONS HARDWOOD LUMBER CO.*[82]

Weyerhaeuser raised the issue of identifying the appropriate standard for "predatory buying" claims under Section 2 of the Sherman Act. Ross-Simmons, a saw mill in the Pacific Northwest, alleged that Weyerhaeuser overpaid for alder sawlogs in a scheme designed to drive its rivals out of business. The district court instructed the jury that Ross-Simmons was required to prove that Weyerhaeuser engaged in "conduct that has the effect of wrongly preventing or excluding competition or frustrating or impairing the efforts of the firms to compete for customers within the relevant market." With respect to the "predatory buying" allegation specifically, the district court instructed the jury that:

> "One of [respondents'] contentions in this case is that the [petitioner] purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent [respondent] from obtaining the logs [it] needed at a fair price. If you find this to be true, you may regard it as an anti-competitive act."[83]

The jury found in favor of Ross-Simmons and awarded US$78.7 million. The U.S. Court of Appeals for the Ninth Circuit affirmed the judgment, despite Weyerhaeuser's contention that the district court erred by not including both prongs of the *Brooke Group* standard in the jury instruction.[84] The DOJ and FTC petitioned the Supreme Court for certiorari and submitted joint amicus briefs recommending that the Court apply the *Brooke Group* standard to predatory buying.

Justice Thomas authored the unanimous decision on behalf of the Supreme Court, which agreed with the position advocated by the enforcement agencies. In predatory buying cases, plaintiffs must demonstrate both that the buyer's conduct led to below-cost pricing of the buyer's outputs and that the buyer "has a

82 Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007). The author participated in this case as a signatory to the Law Professors' Amicus Brief in Support of Petitioner (filed Aug. 24, 2006).

83 Brief for the United States as Amicus Curiae, Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383 (2007) (No. 05-381) (quoting Pet. App. 7a n.8, 14a n. 30).

84 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power."[85] Because Ross-Simmons conceded that it had not satisfied the *Brooke Group* standard, the Court vacated the Ninth Circuit's judgment and remanded the case.

The Supreme Court's endorsement of the *Brooke Group* standard appears to rest on three principles. The first is that "predatory-pricing and predatory-bidding claims are analytically similar" as a matter of economic theory, suggesting that similar legal standards are appropriate.[86] The second is that the Court espouses a view that the probability of successful predatory buying, like predatory pricing, is very low,[87] in part because of the myriad of explanations for "bidding up" input prices in an effort to increase market share and output, hedge against price volatility, or as a result of a simple miscalculation.[88] Finally, the Court notes that, like low output prices, higher input prices may result in increased consumer welfare as firms increase output.[89]

While the Supreme Court does not take the lower court to task for allowing this jury instruction, there appears to be little, if any, doubt that the Supreme Court was correct to reverse the Ninth Circuit's affirmation of a disastrous jury instruction that would require a determination as to whether a firm purchased more inputs than it "needed" or paid more than "necessary." Rather, the Supreme Court focused almost exclusively on the theoretical similarities between predatory pricing and buying, the attributes of the *Brooke Group* standard, and why the economic similarity should translate into symmetrical legal treatment. Interesting questions remain concerning the implications of *Weyerhaeuser,* such as, does this unanimous opinion suggest that the Supreme Court may be willing to adopt the *Brooke Group* test to bundled discounts, "compensated" exclusive dealing, all-units discounts, or other forms of allegedly exclusionary conduct? Regardless, there seems to be very little dispute that the decision is correct on the merits.

I argue that these decisions, taken together, suggest an unmistakable connection to the characteristics of the Chicago School of antitrust analysis discussed earlier. So what is it about these decisions that suggests that the Roberts Court

85 *Weyerhaeuser*, 127 S. Ct. at 1078.

86 *Id.* at 1076 (citing Herbert Hovenkamp, *The Law of Exclusionary Pricing*, 2 COMPETITION POL'Y INT'L 21, 35 (Spring 2006), and John B. Kirkwood, *Buyer Power and Exclusionary Conduct*, 72 ANTITRUST L.J. 625 (2005)).

87 *Id.* at 1077 (citing *Brooke Group*, 509 U.S. at 206, for the proposition that "predatory pricing schemes are rarely tried, and even more rarely successful").

88 *Weyerhaeuser*, 127 S. Ct. at 1077.

89 *Id.* at 1077-78.

has adopted a Chicago School approach to antitrust analysis? And, if that is the case, what does it tell us about where this prolific Court might venture next in the world of antitrust jurisprudence? The remainder of this essay is dedicated to a discussion of these questions.

IV. The Roberts Court and the Chicago School

The Roberts Court's productivity in the 2006-2007 Term alone has supplied sufficient fodder to keep both commentators and practitioners busy analyzing this output for likely trends in future antitrust jurisprudence. There is no doubt that this Court is quite comfortable with antitrust. It has not shied away from complex issues requiring analysis of economic theory or, in the case of *Leegin*, overturning century-old precedent. Perhaps this is because the current justices, led by Justices Breyer and Stevens, have significant antitrust experience.[90] Justice Scalia is considered the Court's only true Chicago School adherent. Despite the fact that Justice Breyer taught antitrust at the University of Chicago, he is generally acknowledged as a member of the Harvard School with substantial antitrust expertise.[91]

The new Supreme Court justices are also familiar with antitrust issues. Chief Justice Roberts was involved in a significant amount of antitrust litigation representing both plaintiffs and defendants in a wide variety of cases. Justice Alito's most discussed antitrust moment came in joining an important and vigorous dissent by Judge Greenberg in the controversial and heavily criticized *LePage's* decision.[92]

The antitrust output and experience of these two new Justices certainly would not have allowed one to confidently predict that the Roberts Court's jurisprudence would exhibit a distinctively Chicago School flare. For example, consider the following excerpt from an article written by Chief Justice Roberts in 1994 addressing whether the Supreme Court, at the time, was conservative:

> "In the antitrust area, the Court seems to regain its equilibrium after the dizzying *Kodak* decision of two Terms ago. That decision surprised most observers by upholding a predatory pricing verdict based on dubious if not implausible economic theory. In the 1992–93 Term, in three decisions the Court returned to a regime in which the objective economic realities of the

90 *See* Rosch (2007), *supra* note 1 (documenting the significant experience and written output of the current justices).

91 *See* Kovacic (2007), *supra* note 24, at 67.

92 LePage's Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003).

> marketplace take precedence over fuzzy economic theorizing or the conspiracy theories of plaintiffs' lawyers. This is bad news for professors and lawyers, good news for business."[93]

Admittedly, the implicit critique of *Kodak* appears to be consistent with Chicago School views. But the excerpt also exhibits some aversion to the application of economic theories—at least fuzzy ones—and academic theorizing more generally, and especially when it is detached from real world market conditions and empirical realities. While there are kernels in the antitrust history of both judges that might encourage Chicagoans and Post-Chicagoans, it is a difficult exercise to generalize any antitrust philosophy from these limited sources, and I decline to do so. Instead, I rely on the four 2006-2007 decisions themselves in support of my claim.[94]

Leegin bears all of the identifying marks of Chicago School influence. Justice Kennedy's analysis applies Chicago economic theory to minimum RPM in order to assess its likely competitive effects. The *Leegin* majority recognizes several procompetitive rationales for vertical restraints in the economics literature, many pioneered by Chicagoans, including the use of vertical restraints to facilitate the provision of promotional services in the absence of dealer free-riding. Importantly, *Leegin* at least implicitly broadens the Court's view of the role of vertical restraints outside of the conventional inter-dealer or discount dealer free-riding rationale, which does not appear to explain many instances of RPM. In summarizing the theoretical literature, the Court notes that the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[95]

Leegin also displays the two remaining Chicago School characteristics—reliance on empiricism and sensitivity to error costs in designing antitrust rules. Justice Kennedy certainly displays sensitivity to the available empirical evidence concerning the competitive effects of RPM, emphasizing scholarship showing that the practice is infrequently associated with anticompetitive effects.

93 John Roberts, *Symposium: Do We Have a Conservative Supreme Court?*, 1994 Pub. Int'l L. Rev. 104 (1994).

94 For the purposes of this essay, I do not address the earlier output of the Roberts Court in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006), *Texaco Inc. v. Dagher,* 547 U.S. 1 (2006), and *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006). However, I believe these 2005-2006 Term decisions are largely consistent with the claim advanced here.

95 *Leegin*, 127 S. Ct. at 2714-15 (citing Brief for Economists as Amici Curiae statement that "In the theoretical literature, it is essentially undisputed that minimum [resale price maintenance] can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects").

Specifically, the Court notes that "[t]he few recent studies documenting the competitive effects of resale price maintenance also cast doubt on the conclusion that the practice meets the criteria for a *per se* rule."[96]

Finally, the majority also embraces the error-cost framework. This is not surprising since this framework is embodied in *Business Electronics*, limiting the application of per se rules to restraints that are "always or almost always" anticompetitive. But the Court goes further than such an implicit recognition of the error-cost framework when rejecting the argument that per se illegality is the appropriate antitrust default rule on the grounds that per se rules decrease administrative costs. The Court's response clearly reveals that its view of the proper scope of per se rules is illuminated by Judge Easterbrook's error-cost framework: "*Per se* rules may decrease administrative costs, but that is only part of the equation. Those rules can be counterproductive. They can increase the total cost of the antitrust system by prohibiting procompetitive conduct the antitrust laws should encourage."[97]

Leegin is certainly the strongest example of Chicago School influence on the Roberts Court's recent output. The Court's reasoning is unmistakably influenced by Chicago principles. While the other decisions do not fit quite as perfectly into the Chicago framework, Chicago influence is apparent in both *Twombly* and *Weyerhaeuser*, though largely absent from *Credit Suisse*.

Twombly strongly exhibits two of the three Chicago characteristics set forth above, and arguably the third as well. There is no doubt that the Court's decision to heighten the pleading burden for plaintiffs alleging conspiracy in violation of Section 1 is influenced by the error-cost analysis. As discussed above, the Court explicitly supports its reasoning with reference to the massive social costs imposed by allowing discovery in cases that are not likely associated with real collusion. The Court notes that conspiracy allegations are especially ripe for false positives because parallel conduct might well arise from competitive behavior, and that those considerations favor more rigorous pleading standards.

But does *Twombly* have separate antitrust content, or is it simply an opinion about procedure with some collateral antitrust implications? I would argue that it does have consequences for antitrust. Justice Souter's opinion extends the logic of *Matsushita* and *Monsanto*, seeking to avoid false inferences of conspiracy at the pleading stage.[98] This extension itself has important antitrust implications. One

96 *Id*. at 2715 (citing T. Overstreet, Resale Price Maintenance: Economic Theories and Empirical Evidence 170 (FTC 1983), and Pauline Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263, 292-93 (1991)).

97 *Id.* at 2718 (citing Frank Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 158 (1984)).

98 Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986); Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

such implication is that lower courts will be faced with the challenge of assessing whether conditions tending to exclude the possibility of independent action are present before discovery has occurred.

But where does a court turn to evaluate whether the "common economic experience" and market conditions are conducive to agreement? The answer is economic theory and an evaluation of empirical realities. Specifically, the modern oligopoly theory built upon the work of Chicago's George Stigler lays the foundation for this analysis in a manner that provides useful guidance to courts by focusing on the conditions that lower the costs of forming, monitoring, and enforcing a collusive agreement.[99] *Twombly* requires lower courts to evaluate market realities to determine whether they are consistent with those conditions that would support an inference of conspiracy.

Returning to the claim that *Twombly* was influenced by Chicago logic, the majority's analysis also displays commitment to the application of economic theory. *Twombly*'s primary antitrust lesson is that lower courts are to analyze the plausibility of the conspiracy allegations in light of "common economic experience." This lesson combines the Chicago School principles of application of economic theory and the centrality of empiricism. What role does evaluation of the common economic experience have in determining plausibility? *Twombly*'s analysis of market conditions suggests that rational, profit-maximizing, and independent action is the likely explanation of the ILECs' parallel conduct. Applied outside the case itself, *Twombly* requires that the market conditions must be conducive to coordination and tend to exclude the possibility of independent action.

Weyerhaeuser also fits nicely into the Chicago School framework described above, with respect to its application of economic theory to predatory bidding, and its consistency with the error-cost framework. Justice Thomas's opinion, however, demonstrates very little interest in empiricism. As discussed above, Justice Thomas's opinion on behalf of the unanimous Court begins with what reads much like a literature survey, noting the consensus view of economists that predatory buying is analytically identical to predatory pricing. This reliance on economic theory allows the Court to both equate monopsony and monopoly analysis for the purposes of antitrust and set the stage to adopt the *Brooke Group* standard. The reliance on *Brooke Group* makes clear that the error-cost framework plays a central role in Justice Thomas's analysis, relying on both the low probability of competitive harm associated with predatory buying, as well as the economic logic that predatory pricing is likely to benefit consumers, to justify adoption of the *Brooke Group* standard.[100]

99 *See* Stigler (1964), *supra* note 28; *see also* Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 Antitrust Bull. 143, 150 (1993) ("Stigler profoundly changed the way economists understand coordination among oligopolists; and his analysis has also influenced antitrust law.").

100 *Weyerhaeuser*, 127 S. Ct. at 1077.

I concede that *Credit Suisse* simply does not fit this framework quite as well as the other cases. One could argue that *Credit Suisse* is at least partially motivated by error-cost concerns. Indeed, the Court does mention its concern that:

> "[A]ntitrust courts are likely to make unusually serious mistakes in this respect. And the threat of antitrust mistakes … means that underwriters must act in ways that will avoid not simply conduct that the securities law forbids (and will likely continue to forbid), but also a wide range of joint conduct that the securities law permits or encourages (but which they fear could lead to an antitrust lawsuit and the risk of treble damages)."[101]

However, the case is neither especially consistent with, nor contradicted by, the other two fundamental Chicago School principles, and presents relatively unique and idiosyncratic issues concerning the regulatory overlap between SEC regulation and antitrust law.

Nonetheless, the Roberts Court's antitrust output generally appears to embrace the Chicago School principles identified in Section II. I offer this as a descriptive theory of these cases rather than a normative judgment on their merits. Such a description may be useful in its own right in highlighting these aspects of the Roberts Court's antitrust jurisprudence. Nor do I wish to overstate my claim as denying the existence of any distinctively Harvard or Post-Chicago themes in these cases. Nevertheless, for the most part, I believe that these cases largely adopt what can accurately be described as a Chicago School approach.

One can anticipate the objection that the Supreme Court, at least since *Sylvania*, has long been influenced by the Chicago School and so the Roberts Court's antitrust output is merely reflective of the status quo that persisted prior to the 2006-2007 Term. While that argument is not without merit, and it is certainly true that Chicago School principles are not new to Supreme Court antitrust jurisprudence, it was unclear, prior to the last Term, that the Roberts Court would adopt a Chicago School approach to antitrust analysis. Even if it were true that the Roberts Court's antitrust jurisprudence represents a mere continuation of a pre-existing trend, that point would not detract from the importance of identifying the distinctive themes displayed by the Roberts Court, which has proven itself to be unique in its productivity, its willingness to engage antitrust issues, and its familiarity and expertise with the subject matter. These points aside, another useful application of this descriptive theory is the generation of some predictions concerning the future antitrust output of the Roberts Court.

101 *Credit Suisse*, 127 S. Ct. at 2396.

V. Some Predictions

The Roberts Court's interest in, and proclivity for, antitrust analysis raises the question of where will the Court go next? Is the Court going to limit itself to clean-up decisions such as *Independent Ink* and *Leegin* that correct long-standing and broadly criticized precedents? Will the Court intervene only in cases where an economic consensus is apparent in the literature, such as *Weyerhaeuser* and *Leegin*, rather than engaging in its own hands-on economic analysis? An aversion to taking on complex antitrust issues where such a consensus does not exist might explain the Court's unwillingness to grant certiorari in *Tamoxifen*.[102] Or will the Court be willing to engage some of the more difficult and complex issues of the day, such as addressing the correct standard for unilateral "exclusionary pricing" in cases such as *LePage's*? Or perhaps the Roberts Court will tackle a horizontal merger case. To conclude, I offer some predictions on topics that the Supreme Court may take on in the near future that follow the analysis in this paper.[103]

The first prediction is that the Roberts Court will finally take on a horizontal merger case. The Supreme Court has not offered any substantive guidance on horizontal mergers in over 30 years,[104] allowing merger analysis to develop within the lower courts, with substantial influence from the antitrust agencies in the form of the *Horizontal Merger Guidelines*. There are, of course, significant obstacles to the Supreme Court addressing a merger case in the near future (even if it is so inclined) such as the elimination of automatic direct appeal.

Nonetheless, a Supreme Court merger opinion may be consistent with the pattern exhibited in the 2006-2007 Term. Economic theory, and the *Horizontal Merger Guidelines*, both suggest that the structural presumptions in current Supreme Court jurisprudence do not make much economic sense, and do not reflect modern economic learning concerning the potential unilateral effects of mergers, or the competitive effects of mergers. The Supreme Court may take advantage of this economic consensus and clean up this troublesome area of law. Such a decision would be consistent with the Supreme Court's revealed preference for relying on economic consensus to overturn problematic, if not long-lived, precedents.[105]

102 In re Tamoxifen Antitrust Litig., 466 F.3d 187 (2d Cir. 2006), *cert. denied*, 127 S. Ct. 3001 (2007).

103 The Supreme Court is likely to return to the issue of identifying the appropriate measure of cost in predatory pricing cases, evidenced by the fact that it granted certiorari in *Spirit Airlines, Inc. v. Northwest Airlines Inc.*, 431 F.3d 917 (6th Cir. 2005), on this issue, but was taken off the Court's docket because it was not filed before a deadline.

104 United States v. General Dynamics Corp., 415 U.S. 486 (1974).

105 *See, e.g.*, Joshua Wright, *Von's Grocery and The Concentration-Price Relationship in Grocery Retail*, 48 UCLA L. Rev. 743, 773 (2001) ("Beyond the inherent conceptual inconsistencies of the *Von's Grocery* decision and its inability to contribute to modern enforcement of the Sherman Act, failure to overturn *Von's Grocery* results in the very danger that stare decisis and antitrust enforcement agencies have attempted to avoid—unreliability").

In the same spirit, I predict the Roberts Court will overturn *Jefferson Parish's*[106] modified per se rule in favor of the rule of reason, thus eliminating the last vestiges of the hostile approach to vertical contracting practices of antitrust eras past.[107] This is another area that matches the criteria set forth above. Economic theory suggests, and the economic literature demonstrates, an overwhelming consensus that, as with RPM, there are numerous pro-competitive explanations for tying. The empirical evidence, if only in the form of ubiquitous tying in the economy by firms both with and without any market power of antitrust concern, bolsters the case for abandoning the per se rule. Finally, application of the error-cost framework to tying suggests a structured rule of reason approach adopting a presumption of legality—certainly not the per se rule of illegality.[108]

I PREDICT THE ROBERTS COURT WILL OVERTURN *JEFFERSON PARISH'S* MODIFIED PER SE RULE IN FAVOR OF THE RULE OF REASON, THUS ELIMINATING THE LAST VESTIGES OF THE HOSTILE APPROACH TO VERTICAL CONTRACTING PRACTICES OF ANTITRUST ERAS PAST.

A third prediction is that the Court will eventually agree to hear a case challenging patent settlements in the pharmaceutical industry involving reverse payments, although it did not grant certiorari in *Tamoxifen* this year. One view of the Court's denial of certiorari on reverse payments cases to date is that the consensus economic and empirical view on these issues is still emerging, as evidenced by the antitrust agencies' disagreement between themselves as to the ripeness of reverse payment cases for review. In any case, reverse payments do not present quite the low-hanging fruit presented in cases such as *Weyerhaeuser* and *Leegin*. However, a circuit split on these issues is likely to develop, and our empirical knowledge of these settlements is likely to improve over time with increased study, both of which militate in favor of a future grant of certiorari.

I conclude with one area where I am less convinced that the Roberts Court will apply its impressive energies in the antitrust realm—exclusionary pricing in the form of bundled rebates or loyalty discounts. While there is broad consensus that *LePage's* adopted a nonsensical "harm to competitor" standard in lieu of requiring harm to competition, and while many have argued that *Brooke Group* or a modified *Brooke Group* approach should apply to all discounting conduct, no real consensus has emerged as to the appropriate test to apply to bundled rebates or loyalty discounts. In addition, the economic literature on bundled rebates and loyalty discounts is still developing, with much attention paid to anticompetitive theories that have not yet been subjected to empirical testing and, therefore, may

106 Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

107 *See* David S. Evans, *Tying: The Poster Child for Antitrust Modernization, in* ANTITRUST POLICY AND VERTICAL RESTRAINTS (Robert W. Hahn ed. 2006).

108 Evans & Padilla (2005), *supra* note 33, apply the error-cost framework to tying and reach this conclusion.

not be "ready for primetime."[109] Moreover, economic research exploring procompetitive justifications for bundled rebates, partial and limited exclusive contracts, and loyalty discounts is still emerging. In the absence of any economic or empirical consensus, and no clear benefit in deviating from the rule of reason approach to exclusionary pricing cases, it is unlikely that the Court will be motivated to address these issues.

109 *See* Kobayashi (2005), *supra* note 20.

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Harvard, Not Chicago: Which Antitrust School Drives Recent U.S. Supreme Court Decisions?

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Harvard, Not Chicago: Which Antitrust School Drives Recent U.S. Supreme Court Decisions?

Einer Elhauge

The U.S. Supreme Court has now decided 14 antitrust cases in a row in favor of the defendant. But this does not indicate an embrace of the conservative Chicago School over the moderate Harvard School. To the contrary, on every issue the Court has addressed where those two schools are in conflict, the Supreme Court has sided with the Harvard School. It has also sided with sound antitrust economics rather than with formalisms favoring plaintiffs or defendants.

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After a long antitrust slumber, the U.S. Supreme Court has become active again in antitrust law, deciding seven cases in the last two years. Since all seven of these cases were decided against the plaintiff, one might think the Court has finally decided to implement the highly conservative Chicago School of antitrust. But so far, it shows no signs of doing so. Rather, while its opinions indicate a determination to cut back on some excesses from an earlier era of pro-plaintiff antitrust decisions, they also indicate an embrace of the moderate Harvard School approach to such issues, rather than an embrace of Chicago School principles. They further indicate a clear embrace of using sound economic analysis to resolve antitrust issues, rather than a resort to either the old formalisms that favored plaintiffs, or new formalisms that try to favor defendants.

My apologies in advance to other great universities for referring to the schools of antitrust thought as the Harvard and Chicago Schools. Many notable scholars who fit these schools are at neither university. I employ the Harvard and Chicago School terminology simply because it is in such widespread usage, and has a historical significance that helps convey the gist of two antitrust philosophies.

I. *Leegin* and Vertical Distributional Restraints

Let's start with *Leegin*, the case that finally overruled *Dr. Miles* and the per se rule against vertical minimum price-fixing.[1] If anything was a topic of consensus among the Harvard and Chicago Schools, it was the proposition that this rule of per se illegality was misguided. But unlike the Harvard School, Chicago School scholars generally take the next step of insisting the proper rule is per se *legality*.[2] The Supreme Court indicated no sympathy for this position in *Leegin*. To the contrary, it was only able to muster a 5-4 majority to overrule *Dr. Miles* at all, and even the majority stressed the need for "diligent" rule of reason scrutiny.[3]

Notwithstanding the sharply divided result, the Court was actually in unanimous agreement that the relevant antitrust economics indicated that vertical minimum price-fixing could have both anticompetitive effects and pro-competitive efficiencies.[4] Given that this is the classic recipe for applying rule of reason review, what was the dispute about? Basically the dissent took the position that,

1 Leegin Creative Leather Products v. PSKS, Inc., 127 S. Ct. 2705 (2007); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

2 Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 9, 23-26 (1981); Robert H. Bork, The Antitrust Paradox 288 (1978) ("every vertical restraint should be completely lawful"); Frank H. Easterbrook, *Workable Antitrust Policy*, 84 Mich. L. Rev. 1696, 1700-01 (1986) ("Chicago School . . . seems to favor little other than prosecuting plain vanilla cartels and mergers to monopoly").

3 *Leegin*, 127 S. Ct. at 2719.

4 *Id.* at 2714-20; *id.* at 2727-30 (Breyer, J., dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

given the mixed economic theory, the case should be resolved, not by the traditional test for deciding whether to apply per se scrutiny, but rather by the empirical evidence or by the doctrine of stare decisis. Neither argument was persuasive, though the strongest grounds for rebuttal were missed by the majority. Those grounds are worth reviewing in detail because the persuasiveness of this holding remains relevant to states or other nations deciding whether to follow this decision, as well as to Congress in deciding whether to override it statutorily.

The empirical evidence stressed by the dissent was that:

(1) during the period of the Fair Trade Acts, retail prices were higher in states that had passed statutes allowing vertical minimum price-fixing than in states that had not; and

(2) retail prices were lower after repeal of those acts than before.[5]

The majority offered the true, but rather weak, response that higher prices might be pro-competitive if they were coupled with more services that consumers wanted.[6] The more powerful response would have been that this empirical evidence addressed the wrong question, because it compared prices in states with per se illegality to prices in states with a rule of per se legality. A rule of per se legality is likely to allow more anticompetitive effects than a rule of reason that remains available to redress anticompetitive forms of the conduct. Thus, the price effects of switching from per se illegality to per se legality are not the same as switching from a rule of per se illegality to a rule of reason, which was the relevant issue here. These studies do, however, provide powerful empirical refutation of the Chicago School position favoring per se legality.

As for stare decisis, it seems rather late in the day to argue that judicial interpretations of antitrust laws should be governed by a strong rule of statutory stare decisis.[7] As the majority correctly noted, the text of the U.S. Sherman Act incorporates capacious common law language that has long been thought to effectively delegate antitrust issues to the Courts for ongoing common law resolution.[8] As a matter of practice, the Court, in fact, overrules antitrust decisions in common

5 *Id.* at 2727-28 (Breyer, J., dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

6 *Id.* at 2718-19.

7 *See generally* Einer Elhauge, Statutory Default Rules 211-24 (Harvard Univ. Press 2008) (forthcoming) (explaining theoretical basis for a fairly strong doctrine of statutory stare decisis, but noting the several grounds for exceptions to this basis and doctrine).

8 *Leegin*, 127 S. Ct. at 2720-21; Elhauge (2008), *supra* note 7, at 29, 215.

law fashion all the time.[9] Indeed, in this very area, the Court had already overruled the per se rules against vertical maximum price-fixing and vertical non-price restraints.[10] The dissent tried to argue that the statute repealing the Fair Trade Acts indicated a legislative preference for bringing back the per se ban on vertical minimum price-fixing,[11] but the majority was right that the repeal could more plausibly be read as indicating a preference for returning the issue to federal courts for common law resolution.[12]

The dissent fell back on the argument that this was too dramatic a doctrinal shift to be justifiable as gradual common law decision-making.[13] The majority responded by noting that the decisions overruling the per se rules against vertical maximum price-fixing and vertical non-price restraints were based on reasoning that was equally applicable to the per se rule against vertical minimum price-fixing, and had left the latter a lonely outlier that did not seem to fit the surrounding doctrinal landscape.[14] But that argument was not totally convincing because the mix of anticompetitive effects to pro-competitive ones was somewhat worse for vertical minimum price-fixing, and the per se rule against it had existed for five decades before the other vertical per se rules made their appearance on the antitrust law scene.[15]

Once again, I think the majority missed a more powerful argument. The bigger problem of doctrinal fit was that, given recent Supreme Court precedent, the per se rule against *horizontal* price-fixing no longer applies in cases where such price-fixing allegedly advances the pro-competitive purposes of a productive business relationship.[16] Adhering to *Dr. Miles* would thus have meant having

9 *See, e.g.,* Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006) (overruling the old doctrine that market power in a tying case could be inferred from the existence of a patent); Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) (overruling the doctrine that a corporation could conspire with a wholly owned subsidiary); U.S. Steel Corp. v. Fortner Enters., 429 U.S. 610 (1977) (holding that the per se rule against tying required independent proof of tying market power, even though prior cases had not required such proof).

10 *See* Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1977) (overruling per se rule against vertical non-price restraints); State Oil Co. v. Khan, 522 U.S. 3 (1997) (overruling per se rule against vertical maximum price-fixing).

11 *Leegin*, 127 S. Ct. at 2732-33 (Breyer, J., dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

12 *Id.* at 2723-24.

13 *Id*. at 2737 (Breyer, J., dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

14 *Id.* at 2721-22.

15 *Id*. at 2736-37. (Breyer, J., dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

16 The current horizontal doctrine is largely the product of three cases. In Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979), the Court held that the per se rule does not apply if horizontal price-fixing advances the pro-competitive purposes of a productive business relation. In

antitrust law treat vertical minimum price-fixing that allegedly advances the pro-competitive purposes of a productive business relationship between a supplier and distributor *worse* than the law treats horizontal price-fixing that allegedly advances the pro-competitive purposes of a productive business relationship. While vertical minimum price-fixing may be marginally more likely to be anticompetitive than other vertical distributional restraints, there can be no doubt that it is far less likely to be anticompetitive than horizontal price-fixing. Thus, if horizontal price-fixing gets rule of reason scrutiny when it is allegedly ancillary to a productive business relationship, it would be perverse to give stricter scrutiny to vertical price-fixing, which is always ancillary to some permissible business relationship between the manufacturer and dealer.

If horizontal price-fixing gets rule of reason scrutiny when it is allegedly ancillary to a productive business relationship, it would be perverse to give stricter scrutiny to vertical price-fixing.

As for the dissent's claim that overruling *Dr. Miles* would create a sea change in legal practice, the majority responded that enforcement of *Dr. Miles* was limited by two doctrines.[17] First, under *Business Electronics*, ambiguous agreements (including even a vertical agreement to terminate a retailer because of price-fixing) were interpreted to constitute a vertical non-price agreement subject to rule of reason scrutiny rather than per se scrutiny.[18] Second, under *Colgate* and *Monsanto*, if a supplier demanded that its dealers adhere to minimum resale prices and those dealers acquiesced by complying with the minimum resale prices, it was not deemed a vertical agreement at all.[19]

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footnote 16 cont'd

Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982), the Court made clear that the mere existence of some productive business relation was not sufficient to oust the per se rule. Rather, it held that the per se rule continues to apply if the price-fixing is not alleged to advance the pro-competitive purposes of that relationship. The fact that the price-fixing advances pro-competitive justifications that are unrelated to the productive business relationship does not create any exception to the per se rule. Then, in NCAA v. Board of Regents of Univ. of Oklahoma, 468 U.S. 85 (1984), the Court held that the per se rule does not apply if the horizontal price-fixing or output restraint is alleged to advance the pro-competitive purposes of a productive business relation, although it also made clear that such an alleged connection might be rejected on possibly abbreviated rule-of-reason review. *See generally* Einer Elhauge & Damien Geradin, Global Antitrust Law & Economics 190-91 (Foundation Press 2007) (summarizing the current contours of the horizontal doctrine).

17 *Leegin*, 127 S. Ct. at 2721-22.

18 Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988).

19 Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984); United States v. Colgate & Co., 250 U.S. 300 (1919).

All true, but once again more powerful responses were left unmentioned. The reality is that there was little real enforcement of the per se rule against vertical minimum price-fixing. The reasons are plain once one considers the possible categories of litigants. U.S. enforcement agencies rarely, if ever, brought actions against vertical minimum price-fixing because they were persuaded by the economic critique of *Dr. Miles*. Rival manufacturers or retailers lack standing to bring suit against vertical minimum price-fixing, because they cannot show antitrust injury given that they would actually benefit if such an agreement caused other manufacturers or retailers to charge anticompetitively high prices.[20] Consumers do have antitrust standing, but to prove injury and damages they must prove a net anticompetitive effect, which requires satisfying an effective rule of reason that negated the practical advantage of any per se rule on liability. And, in fact, consumers hardly ever brought such suits.

The upshot was that the per se rule against vertical minimum price-fixing was generally invoked only by dealers themselves, as in *Leegin*, either in a suit brought to challenge their termination for noncompliance, or defensively to avoid enforcement of such an agreement. This did not provide that much enforcement where dealers were willing participants. It might even have produced the anticompetitive effect of making manufacturers reluctant to replace dealers who are performing poorly for other reasons, because those dealers could bring a lawsuit claiming their termination was for non-compliance with resale price agreements, taking advantage of a per se rule that did not require them to show any actual anticompetitive effect on the market. Ending such suits hardly seems like a big change, nor an unsalutary one.

Relatedly, the dissent also stressed reliance on the old per se rule.[21] The majority responded by stating that:

(1) reliance interests could not justify retaining an inefficient rule;

(2) any reliance was fairly weak because doctrines like *Monsanto* allowed minimum prices to be fixed in other ways;

(3) the fair trade laws meant vertical minimum price-fixing was legal in most states until 1975, thus making the length of time not that different from the overruled doctrine on vertical maximum price-fixing, and no more than 10 percent of goods were covered by vertical minimum price-fixing when it was legal.[22]

20 Atlantic Richfield v. U.S.A Petroleum, 495 U.S. 328 (1990).

21 *Leegin*, 127 S. Ct. at 2735-36 (Breyer, J, dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

22 *Id.* at 2724-25.

All these points could have been made more powerfully. The first point, the dissent noted, amounted to just bare assertion without reasoning.[23] But there is a strong theoretical basis for the majority's assertion, which it unfortunately failed to cite. Mainly, scholarship by academics like Professor Kaplow has shown that if a legal change would be efficient, then the law should require parties to bear the risk of legal change, rather than making their reliance a reason to avoid that change, because forcing parties to bear that risk produces the optimal level of reliance.[24] More recent work by Professor Shavell emphasizes that reliance may nonetheless provide grounds not to change the law when reliance increases the costs or reduces the benefits of a legal change, such as when a technological investment makes a shift to new pollution controls more costly or less beneficial.[25] The reason is that, in such cases, the reliance can alter whether the legal change is, in fact, efficient. Here, there seemed to be little reason to think that any reliance on the per se rule of illegality would alter whether efficiency would be advanced better by a rule of reason.

If a legal change would be efficient, then the law should require parties to bear the risk of legal change, rather than making their reliance a reason to avoid that change.

The second point was fine as far as it went, but could have been made more forcefully, given the lack of real enforcement, noted above, even for clear vertical minimum price-fixing. The third point was also accurate, but the dissent persuasively noted that 10 percent today would constitute US$300 billion of trade—hardly chopped liver.[26] The stronger response would have been that the dissent offered no grounds to think that reliance meaningfully differed depending on whether the overruled doctrine had been around for 96 years, as in the present case, or for 10 or 29 years respectively, as with the per se rules against vertical non-price and maximum price restraints that were overruled in *GTE Sylvania* and *Khan*. One would think that any meaningful economic reliance at the time of an overruling decision would likely have been incurred within the prior ten years.

So, it seems clear that, under standard Harvard School principles, the majority was right to overrule the per se rule against vertical minimum price-fixing. The puzzle is what provoked a vigorous dissent from Justice Breyer; one of the world's most sophisticated antitrust justices, whose opinions generally have been fully

23 *Id.* at 2735 (Breyer, J, dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

24 *See* Elhauge (2008), *supra* note 7, at 306-07 (summarizing literature and its implications for reliance arguments in statutory interpretation).

25 *Id.* at 307-08.

26 *Leegin*, 127 S. Ct. at 2735-36 (Breyer, J, dissenting, joined by Stevens, Souter & Ginsburg, JJ.).

within the Harvard School. Part of the reason may be that the majority failed to express the stronger grounds for its conclusion that I just described. But the fact that Breyer's dissent referred no less than six times to the stare decisis considerations that were cited in a case about restrictions on issue-advocacy ads by a right-to-life group made one wonder whether the *Leegin* case had gotten mixed up with larger political disputes about abortion and campaign finance regulation.[27]

In any event, several features of the Court opinion made clear that it was embracing only the moderate Harvard School critique of *Dr. Miles*, and not the more extreme Chicago School critique. The Chicago School critique rests largely on the notion that, because manufacturers generally want to minimize retail markups, they have optimal incentives to weigh any adverse effects on retail markups against any pro-competitive efficiencies. Thus, that School argues, a rule of per se legality would be better because courts are unlikely to weigh the anticompetitive and pro-competitive effects better than manufacturers with optimal incentives. The Court recognized that this was true "in general" and "usually," but not always.[28] Instead, the Court emphasized that manufacturers would lack optimal incentives when vertical minimum price-fixing helped facilitate price coordination among manufacturers or the vertical exclusion of smaller rivals, and that vertical minimum price-fixing might reflect the incentives of retailers, which are not pro-competitive.[29] If vertical minimum price-fixing were really per se legal, then such anticompetitive usages of it (which are possible without any horizontal agreement) would be immune from antitrust enforcement.

Far from embracing the Chicago School position that vertical minimum price-fixing should be per se legal, the Court affirmatively stated that "[v]ertical agreements establishing minimum resale prices can have either procompetitive or anticompetitive effects."[30] Nor did the Court advocate a lax version of the rule of reason that could amount to a de facto rule of per se legality. To the contrary, the Court stressed that "resale price maintenance … does have economic dangers," and that in applying the rule of reason, courts "have to be diligent in eliminating their anticompetitive uses from the market."[31]

The Court's statements about how rule of reason review should be conducted reflected a further rejection of Chicago School principles. *Leegin* suggests various

27 *Id.* at 2731, 2734-35, 2737 (Breyer, J, dissenting, joined by Stevens, Souter & Ginsburg, JJ.) (citing six times to Federal Election Comm'n v. Wisconsin Right to Life, Inc., 127 S. Ct. 2652 (2007) (Scalia, J., concurring in part and concurring in judgment).

28 *Leegin*, 127 S. Ct. at 2718-19.

29 *Id.* at 2716-17.

30 *Id.* at 2717.

31 *Id.* at 2719.

things about how to conduct rule-of-reason analysis in future vertical minimum price-fixing cases. One is to dismiss cases where "only a few manufacturers lacking market power adopt the practice," but to use more careful scrutiny "if many competing manufacturers adopt the practice."[32] This is quite similar to the long-established approach for vertical exclusionary restraints like exclusive dealing, where Supreme Court precedent dictates aggregating the shares covered by similar vertical restraints by other manufacturers in concentrated markets.[33] But Chicago School adherents have wrongly sought to change this well-established aggregation standard, based largely on odd formalisms.[34] A more balanced economic approach, going back to Harvard School exemplar Professor Areeda, shows that aggregation is, instead, the correct approach when the manufacturers are large players in concentrated markets.[35] *Leegin* indicates that the Supreme Court has not only rejected the Chicago School efforts to overrule this aggregation doctrine, but has extended the doctrine to vertical minimum price-fixing.

What lies in the future? One nice feature of *Leegin* is that it eliminates the need to continue drawing the confusing *Business Electronics* distinction between vertical price-fixing agreements and agreements to terminate dealers because of price-fixing, because both now get the same rule-of-reason scrutiny. Perhaps it is not too much to hope that *Leegin* might also eliminate the arguably even more confusing *Monsanto* distinction between vertical agreements and manufacturer demands followed by dealer acquiescence. That distinction was always hard to make sense of, given that demands and acquiescence could well suffice to show a binding legal contract, and especially given that *Monsanto* itself found an agreement even though the evidence in that case showed nothing but demands followed by acquiescence.[36] To the extent that the *Monsanto* distinction made any sense at all, it seemed driven by a desire to narrow a per se rule that lacked a sound economic basis, and by a general sense that vertical price-fixing was less likely to be anticompetitive if initiated by the manufacturer. By overruling the per se rule, *Leegin* eliminates the motive to narrow that rule by finding non-agreements. Further, *Leegin* suggests that, rather than driving find-

PERHAPS IT IS NOT TOO MUCH TO HOPE THAT *LEEGIN* MIGHT ALSO ELIMINATE THE ARGUABLY EVEN MORE CONFUSING *MONSANTO* DISTINCTION BETWEEN VERTICAL AGREEMENTS AND MANUFACTURER DEMANDS FOLLOWED BY DEALER ACQUIESCENCE.

32 *Id.*

33 *See* Elhauge & Geradin (2007), *supra* note 16, at 516-17 (collecting sources).

34 *Id.* at 516 n. 20.

35 *Id.* at 517-19.

36 *Id.* at 794-95.

ings of non-agreement, whether the manufacturer or dealer initiated the vertical price-fixing restraint should instead be a factor considered in determining whether the restraint was likely to be anticompetitive under the rule of reason.[37]

Softening the legal effect of who initiated the restraint makes sense. Even if a dealer initiated the restraint, dealers have incentives to offer terms that they think manufacturers will find efficient and profitable. Further, even if a manufacturer initiated the restraint, any individual manufacturer has incentives to get dealers to carry its products by offering terms it knows a powerful dealer or dealer cartel will find profitable, even if those profits come at the expense of consumer welfare. Moreover, the Court itself acknowledged that manufacturers could have their own anticompetitive incentives for imposing vertical minimum price-fixing.

II. *Weyerhaeuser* and Predatory Buying

Next consider *Weyerhaeuser*, the case that held that proving predatory buying requires evidence that the defendant overpaid so much for the inputs that the price of the predator's output was below cost.[38] This holding fit very well with the traditional Harvard School test, dating back to Professors Areeda and Turner, which requires evidence that predatory pricing be below cost.[39] But it fit very poorly with the traditional Chicago School argument that predatory pricing should be per se legal.[40]

One might argue that stare decisis made the Court reluctant to adopt a rule of per se legality. But we have seen above that the stare decisis doctrine usually poses little constraint in antitrust cases. Further, stare decisis did not apply here at all because there was no Supreme Court precedent on predatory buying, just on predatory selling. The Court had the ready ground for distinction that predatory buying is, if anything, less likely to be harmful to consumers than predatory pricing, because it may be designed to create upstream monopsony power that might not meaningfully affect the downstream prices paid by consumers. Indeed, had the Court simply held that a predatory buying claim required proof that the conduct was likely to allow recoupment through enhanced monopoly power in

37 *Leegin*, 127 S. Ct. at 2719-20.

38 Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber, 127 S. Ct. 1069 (2007).

39 Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697 (1975); Einer Elhauge, *Why Above-Cost Price Cuts to Drive out Entrants Do Not Signal Predation or Even Market Power – and the Implications for Defining Costs*, 112 Yale L.J. 681 (2003).

40 Bork (1978), *supra* note 2, at 154; Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. Pa. L. Rev. 925, 927 (1979); Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. Chi. L. Rev. 263 (1981).

the downstream output market, that would have effectively eliminated any distinctive claim for predatory buying, because such a claim would require proof of the same elements that already prove predatory pricing:

(1) below-cost pricing in the output market; and

(2) a sufficient likelihood of recoupment through enhanced monopoly power in the downstream output market.

One might also object that the lawyers did not argue that predatory buying should be per se legal, just as they did not argue that vertical minimum price-fixing should be per se legal. But lawyers make arguments that they think will succeed, so if they did not make those arguments it must reflect their assessment that the Court would be unreceptive to them.

Other features of the opinion confirmed the Supreme Court's moderate, unconservative approach, to antitrust law. First, conservatives sometimes take the view (especially in merger cases) that because monopsony power lowers prices, it should be deemed less problematic than monopoly power. The *Weyerhaeuser* Court gave us a ringing rejection of this view, explicitly holding that it regarded monopsony and monopoly power as equivalent problems.[41]

Second, antitrust conservatives often take the view that antitrust law should not condemn conduct that creates anticompetitive effects upstream if that conduct could not have any anticompetitive effect downstream in consumer markets, and thus could not harm consumer welfare. The Court squarely rejected this theory, holding that it would suffice to prove illegal predatory pricing to prove both:

(1) that input prices were bid up to a level that made the output below cost; and

(2) that the defendant had a dangerous probability of recouping those losses with enhanced monopsony power in the upstream input market.

Weyerhaeuser thus makes it unnecessary to show that the predatory buying would impair rivals in the downstream output market enough to lead to the sort of enhanced monopoly power in that market that would lead to higher consumer prices.

For example, in *Weyerhaeuser* the input market for logs was regional, whereas the output market for finished lumber seems to have been national. The defendant, Weyerhaeuser, may not have had any monopoly power in the national output market, its conduct may not have affected national output prices at all, and eliminating one small rival like Ross-Simmons may not have enabled it to recoup any lost profits in the national output market. In contrast, in the regional input market for logs in the northwestern United States, Weyerhaeuser had a 65 percent buyer share and plausible monopsony power, it had allegedly raised

41 *Weyerhaeuser*, 127 S. Ct. at 1076.

prices on that input market, and driving rivals out of that regional input market might have allowed it to recoup lost profits by paying the regional mills a low monopsony price in the future. The Court held that proof of the latter would suffice, without any need to prove recoupment or the risk of higher prices in the downstream national output market. This holding, that upstream market harm suffices, was fully in line with past Supreme Court precedent on buyer cartels, and with lower court cases on buyer mergers.[42] But *Weyerhaeuser* was the first Supreme Court case to confirm that this notion also applied to unilateral buyer conduct.

This holding also has clear implications for a price-squeeze claim. A predatory buying claim resembles a price-squeeze claim in that, in both instances, the defendant allegedly inflated input prices and left too small a differential between the upstream input price and the downstream output price for rivals to survive. Further, some older lower court decisions on price squeezes utilized a vague test quite similar to the lower court test that the *Weyerhaeuser* Court rejected: their test required only that the upstream price be higher than a fair price and make it hard for the actual rivals to compete.[43] The *Weyerhaeuser* decision indicates that the Court is likely to embrace the position that a price-squeeze claim should require evidence that the price differential between the upstream and downstream prices is lower than the defendant's incremental costs of engaging in the downstream activities.[44]

The *Weyerhaeuser* decision indicates that the Court is likely to embrace the position that a price-squeeze claim should require evidence that the price differential between the upstream and downstream prices is lower than the defendant's incremental costs of engaging in the downstream activities.

42 *See* Mandeville Island Farms v. American Crystal Sugar, 334 U.S. 219 (1948) (condemning a buying cartel in a regional sugar beet market without any proof that it would have a price effect on the downstream national market in refined sugar); U.S. v. Pennzoil, 252 F. Supp. 962 (D. Pa. 1965) (condemning a merger that created local monopsony power in Pennsylvania crude oil market even though it seemed unlikely to affect output in the downstream worldwide market for refined oil); U.S. v. Rice Growers Ass'n, 1986–2 Trade Cas. (CCH) ¶ 67,288 (E.D. Cal.) (condemning a merger that created local monopsony power in California paddy rice market even though it seemed unlikely to affect output in the downstream worldwide market for milled rice); Elhauge & Geradin (2007), *supra* note 16, at 1013 ("Even without higher prices in a downstream market, the creation of monopsony power remains anticompetitive in the upstream market and harmful to sellers in it").

43 *See* United States v. Aluminum Co., 148 F.2d 416 (2d Cir. 1945); Bonjorno v. Kaiser Aluminum & Chem. Corp., 752 F.2d 802, 808-11 (3d Cir. 1984).

44 Elhauge & Geradin (2007), *supra* note 16, at 457-58 (advocating this position and showing that other U.S. appellate courts, and prominent EC judgments, have adopted such a position).

III. *Twombly* and Horizontal Collusion

In *Twombly*, the Court made it clear that interdependent parallel conduct, or mere oligopolistic coordination, does not suffice to show an antitrust conspiracy under U.S. law.[45] This was widely understood before, but surprisingly had never been explicitly decided in prior Supreme Court decisions.[46] *Twombly* further held that a Sherman Act Section 1 complaint should be dismissed if it alleged only parallel conduct coupled with a bare assertion that a conspiracy existed. Some specific fact additional to parallel conduct (often called a "plus factor") must not only be ultimately proven, but alleged in the complaint. This was the widespread practice of lower courts on pleading standards for antitrust conspiracies, but arguably conflicted with some older Supreme Court case law that stated a complaint should not be dismissed unless there was no doubt the plaintiff could prove no set of facts that would support his claim.

Twombly offered little guidance on what the necessary plus factors might be. My own reading is that other Supreme Court case law indicates that the requisite additional evidence could be provided not only by direct evidence of a conspiracy, but also by evidence that indicates that the parallel conduct either was implausible without an explicit agreement or followed common invitations or secret meetings.[47] The lower courts have sometimes gone beyond this to suggest that the requisite plus factor could be shown by a "motivation for common action"—that is, by some indication that the firms would have a disincentive to engage in the conduct unless others did the same.[48] The problem is that this plus factor is true for cases of pure oligopolistic coordination, when no conspiracy is inferred. Another plus factor the lower courts have sometimes used is evidence of adverse economic performance, like excessive prices or profits. But again this is true in cases of pure oligopoly. Thus, such plus factors now seem insufficient after *Twombly*.

All the above is consistent with the Harvard School, which has long concluded that antitrust law should not condemn oligopolistic coordination because firms in oligopolistic markets cannot avoid knowing that their prices are interdependent when each firm sets its own prices, and so it would be hard to define any prohibition in a way that tells firms how to behave.[49] However, it conflicts with Judge Posner's Chicago School view that supra-competitive pricing by an

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45 Bell Atlantic v. Twombly, 127 S. Ct. 1955, 1964 (2007).

46 *See* Elhauge & Geradin (2007), *supra* note 16, at 837.

47 *See id.* at 801-02.

48 *See* Phillip Areeda, Louis Kaplow, & Aaron Edlin, Antitrust Analysis 226–31 (6th ed. 2004).

49 *See* Donald F. Turner, *The Definition of Agreement Under the Sherman Act*, 75 Harv. L. Rev. 655 (1962).

oligopoly should be an antitrust violation, in part because he thinks it is unlikely to occur without an actual agreement.[50] The *Twombly* opinion's continued embrace of a per se rule for horizontal price-fixing also conflicts with Judge Easterbrook's Chicago School position that such agreements should not be illegal unless the conspirators are first proven to have market power.[51]

Perhaps the most interesting feature of *Twombly* is that it recognizes that oligopolistic coordination need not involve coordination on price, but can involve coordination on a strategy of not moving into the areas where rivals compete.[52] This is important because antitrust conservatives often incorrectly assume that oligopolistic coordination and unilateral effects on a differentiated market are mutually exclusive theories. This erroneous assumption rests on the implicit premise that the only relevant coordination is coordination on price, a form of coordination that is difficult unless product offerings are homogeneous, which by definition cannot be true in a differentiated market, where firms have different geographic locations or product characteristics that have varying attractions to different consumers.

Twombly acknowledges that, rather than coordinate on price, firms might coordinate on a strategy of maintaining their differentiated status. If a market exhibits geographic differentiation, then (without any actual agreement) firms might nonetheless coordinate on a policy of not invading the geographic areas of other firms. When a market features product or brand differentiation, firms can coordinate on a policy of not moving into the "spatial" location of the other brands (i.e., refraining from adopting similar characteristics or brand advertising and pricing points). Thus, a merger on a differentiated market might be condemned on the ground that the merger makes it easier to coordinate on maintaining product or geographic differentiation. Proof of a differentiated market thus no longer undermines a theory of oligopolistic coordination.

IV. *Credit Suisse* and the Scope of Antitrust Law

Credit Suisse may be the least-heralded of this term's Supreme Court decisions, but is probably the most important because it has implications for the scope of *all* antitrust doctrines. In this case, the Court held that federal securities law precludes the application of antitrust law when the two are "clearly incompatible" given:

50 *See* Richard A. Posner, *Oligopoly and the Antitrust Laws*, 21 Stan. L. Rev. 1562 (1969).

51 *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Texas L. Rev. 1 (1984), *reprinted in* 1(1) Competition Pol'y Int'l 179 (2005). My own view is that, given costs and errors in adjudicating market power, a market power screen would worsen underdeterence problems without lowering overdeterrence because naked horizontal price-fixing has no pro-competitive justification. Elhauge & Geradin (2007), *supra* note 16, at 105-06.

52 *Twombly*, 127 S. Ct. at 1972.

> "(1) the existence of regulatory authority under the securities law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; . . . (3) a resulting risk that the securities and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct . . . [and] (4) [that] . . . the possible conflict affected practices that lie squarely within an area of financial market activity that the securities law seeks to regulate."[53]

The Court emphasized that the possible conflict need not be a present one. Even if the federal securities agency currently prohibits precisely the same conduct that antitrust law prohibits, it suffices for an antitrust exemption that, in the future:

(a) the agency could create a conflict by choosing to exercise its regulatory authority differently; or

(b) the agency and antitrust courts might interpret or apply their similar prohibitions differently.[54]

None of this deviated much from the implied exemption law of past cases. If the *Credit Suisse* test can be generalized to areas outside of SEC cases, it indicates that an implied antitrust exemption applies if:

(1) a federal non-antitrust agency has an exercised power to regulate the relevant conduct; and

(2) current or future agency choices about how to exercise or apply that power might create a risk of a conflict with antitrust standards on conduct that is squarely within the core area covered by the non-antitrust law.

Two features indicated, however, that the Court was trying to cabin this implied exemption doctrine a bit. First, limiting any implied exemption to the core areas covered by non-antitrust laws indicated a potential narrowing of implied exemption law. Second, the Court suggested in several places that the potential-conflict exemption test might be unique to securities law.[55] Perhaps in the future we will talk of a "securities exemption" in the same way that we now talk about the labor or insurance exemptions, that is, as a sui generis exemption doctrine with its own elements that do not extend to other sorts of cases.

53 Credit Suisse Securities v. Billing, 127 S. Ct. 2383, 2392 (2007).

54 *Id.* at 2390-91, 2394-96.

55 *Id.* at 2389, 2392.

One can see why the Court was worried about applying this standard outside of securities cases. Given the extent of modern federal regulation, it may well be the case that, in most of our economy, some agency has the power to regulate some conduct that might also constitute an antitrust violation. If all such conduct were exempt from antitrust scrutiny, then there could well be little left to the antitrust laws. Further, usually the U.S. Congress has authorized the relevant agency to regulate the conduct in some more limited way, or based on more limited standards that are unrelated to competitive concerns. It seems implausible that in such cases Congress really meant to oust antitrust review, or that doing so would be socially desirable. Instead, Congress may well have intended to express even more concern about the relevant conduct, by indicating it was undesirable not only under competition standards, but under other normative standards as well. In any event, nothing in this opinion indicated any embrace of Chicago School principles, which, if anything tends to be hostile to regulation on the ground that it is likely to reflect anticompetitive interest group capture.[56]

GIVEN THE EXTENT OF MODERN FEDERAL REGULATION, IT MAY WELL BE THE CASE THAT, IN MOST OF OUR ECONOMY, SOME AGENCY HAS THE POWER TO REGULATE SOME CONDUCT THAT MIGHT ALSO CONSTITUTE AN ANTITRUST VIOLATION. IF ALL SUCH CONDUCT WERE EXEMPT FROM ANTITRUST SCRUTINY, THEN THERE COULD WELL BE LITTLE LEFT TO THE ANTITRUST LAWS.

V. Prior Terms

One might think all the above is just an aberration, reflecting the particular cases decided this term. But the same general conclusion holds for other Supreme Court cases decided in recent terms. In 2006, the Court decided three cases, *Texaco, Volvo,* and *Illinois Tool Works*. In *Texaco Inc. v. Dagher*, the Court held that it was not per se illegal for an otherwise lawful joint venture to set the prices at which it sells its products.[57] This case raised no split between the Chicago and Harvard Schools, given that both schools treat joint ventures under the rule of reason, especially since setting prices for the jointly made products was an unavoidable feature of the joint venture.[58]

56 BORK (1978), *supra* note 2, at 347-64; Frank H. Easterbrook, *The Supreme Court, 1983 Term-Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 51-54 (1984).

57 Texaco Inc. v. Dagher, 547 U.S. 1 (2006).

58 *See* ELHAUGE & GERADIN (2007), *supra* note 16, at 96-97 (noting that the price-fixing would be joint even if the joint venture set different prices for the two brands).

In *Volvo*, the Court held that the Robinson-Patman Act prohibition on anticompetitive price discrimination does not apply unless the discrimination is between dealers selling to the same customer.[59] Again, the case raised no real split between the Harvard and Chicago Schools, both of which disdain current Robinson-Patman Act law because, under *Morton Salt*, it infers an anticompetitive effect from the mere existence of secondary-line price discrimination.[60] Although both schools treat that law as bad economics required by a misguided populist statute, the oddity is that, in fact, the statutory text is explicitly contrary to this conclusion in *Morton Salt*.[61] Perhaps in the future, a proper textualist interpretation of the Robinson-Patman Act will restore it to a state of economic rationality.

The third case, *Illinois Tool Works*, held that the market power necessary to prove illegal tying must be directly proven, rather than inferred from the mere existence of a patent.[62] This holding was once again squarely within the Harvard School, which had long advocated the same position,[63] as was the Court's suggestion that pro-competitive justifications might be admissible in a tying case.[64] However, the opinion nowhere suggested any enthusiasm for overruling the doctrine that tying could be illegal based on market power in the tying product, without proof of substantial foreclosure in the tied product.[65] Even less did it indicate any inclination to adopt the Chicago position that tying should be treated as per se legal.[66] Which is all to the good, because modern economic analysis shows that the Chicago position that tying could not increase monopoly profits is based on limited assumptions that seldom apply to real markets.[67]

59 Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164 (2006).

60 FTC v. Morton Salt Co., 334 U.S. 37 (1948).

61 *See* Elhauge & Geradin (2007), *supra* note 16, at 758, 772.

62 Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006).

63 *See* Phillip Areeda, Einer Elhauge, & Herbert Hovenkamp, Antitrust Law ¶ 1737 (1996).

64 *See* Elhauge & Geradin (2007), *supra* note 16, at 553 (discussing this language from *Illinois Tool*); Areeda et al. (1966), *supra* note 63, at ¶ 1760 (1996) (arguing that justifications should be admissible).

65 *See* Elhauge & Geradin (2007), *supra* note 16, at 545-48, 553 (noting that this doctrine makes sense if antitrust doctrine takes the view that either price discrimination or squeezing out consumer surplus is anticompetitive).

66 *See* Bork (1978), *supra* note 2, at 380-81; Posner (1979), *supra* note 40, at 926.

67 *See* Elhauge & Geradin (2007), *supra* note 16, at 544-51.

2005 saw no Supreme Court antitrust cases. In 2004, there were three. *Empagran* held that the U.S. antitrust laws did not apply to a claim of anticompetitive injuries suffered in foreign nations that were independent of any U.S. effects.[68] *Flamingo* held that the U.S. Postal Service could not be an antitrust defendant.[69] Both were jurisdictional issues on which there was no Harvard-Chicago split. *Trinko* was more substantive, holding that a monopolist's duty to deal did not extend to cases where the monopolist had not voluntarily offered the relevant product on the demanded terms to either the plaintiff or anyone else in the past.[70] But the Court did not adopt the position of many Chicago School scholars that unilateral refusals to deal should be per se legal.[71] Indeed, far from overruling the *Aspen* duty to deal, it held that *Aspen* was "at or near the outer boundary" of the antitrust duty to deal, thus not only confirming its continued validity, but also indicating that such a duty might even be extended beyond *Aspen*.[72]

And before 2004? From 2000-2003, there were no Supreme Court antitrust decisions, and there were only four from 1994-1999, none of which raised any conflict between the Harvard and Chicago schools. In 1999, *California Dental* held that abbreviated rule of reason condemnation could not be applied when the defendants offered a theoretically plausible pro-competitive justification for their restraint on advertising.[73] In 1998, *Discon* held that the per se rule against boycotts did not apply to a vertical agreement to refuse to deal with a third party.[74] In 1997, *Khan* overruled the per se rule against vertical maximum price-fixing.[75] Finally, the 1996 *Brown* case held that the labor exemption applied to agreements between employers that were engaged in collective bargaining with unions.[76] The Harvard School is consistent with all of these positions, and I know of no place where the Chicago School has taken a contrary position.

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68 F. Hoffmann-la Roche Ltd. v. Empagran S.A., 542 U.S. 155, 162–63 (2004).

69 *See* United States Postal Service v. Flamingo Indus. (U.S.A) Ltd., 540 U.S. 736 (2004).

70 *See* Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 409 (2004).

71 *See* Richard A. Posner, Antitrust Law 242-44 (2d ed. 2001); Easterbrook (1986), *supra* note 2, at 1700-01.

72 *Trinko*, 540 U.S. at 409. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

73 *See* California Dental Ass'n v. F.T.C., 526 U.S. 756 (1999). *See generally* Elhauge & Geradin (2007), *supra* note 16, at 190-91 (explaining how *California Dental* fits within the doctrinal landscape of horizontal restraint cases).

74 NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998).

75 State Oil Co. v. Khan, 522 U.S. 3 (1997).

76 Brown v. Pro Football, Inc., 518 U.S. 231 (1996).

VI. Conclusion

Since 1994, every U.S. Supreme Court antitrust case has been consistent with the rule that the antitrust defendant always wins. That is a remarkable fourteen cases in a row. But none has ever sided with the Chicago School over the Harvard School on any issue in which the two are in conflict. To the contrary, to the extent the Supreme Court has picked sides in this debate, it has always sided with the Harvard School. Last year's term was no exception.

Although I have not done so here, one could extend this analysis to every Supreme Court case since the 1970's, when the Chicago-Harvard split became clear. None of this is to deny that the reasoning of Chicago School theorists has often been quite influential with the Court, and has been highly valuable in helping move the Court away from some of the ill-founded anti-defendant positions established during earlier formalist periods. But when it comes to actual conclusions, the Court has been much more comfortable with the moderate prescriptions of the Harvard School than with the radical revolution advocated by the Chicago School.

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Tying after *Microsoft*: One Step Forward and Two Steps Back?

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Tying after *Microsoft*: One Step Forward and Two Steps Back?

Kelyn Bacon

In the tying part of the *Microsoft* case, as in the interoperability part of the case, the CFI upheld the Commission's Decision. But it did so on grounds that were confused and inconsistent. For all of the central elements of the case, the CFI appears to have been unable or unwilling to set out a clear statement of principle and apply it properly to the facts. The judgment also sets the CFI in direct conflict with the more economic approach being developed by the Commission in its assessment of Article 82 cases. The only clear signal provided by the CFI in this case is that it will not engage in a reform of Article 82 policy. Fortunately, this does not prevent the Commission from doing so; indeed, the legal uncertainty resulting from this judgment makes clear guidance from the Commission all the more imperative.

The author is a barrister at Brick Court Chambers, London, and in the CFI proceedings represented the Association for Competitive Technology, intervening in support of Microsoft. She is grateful for the helpful comments of Christian Ahlborn (Linklaters) on an earlier draft.

I. Introduction

The second part of the *Microsoft* judgment addresses the integration of Microsoft's media player ("Windows Media Player" or "WMP") with the Windows operating system. WMP had been integrated into Windows since the early 1990s; then in 1999, when Windows 98 Second Edition was released, Microsoft added streaming functionality to WMP, enabling the playback of an audio or video file while it is being downloaded. Microsoft continued to distribute all successive versions of Windows with WMP installed as an integral component of Windows. In its Decision,[1] the Commission considered that the integration of a streaming media player into the Windows operating system constituted an abuse of Microsoft's dominant position in the supply of PC operating systems, by tying two separate products contrary to Article 82 of the EC Treaty. This abuse contributed to the EUR 497 million fine imposed on Microsoft. In addition, the Commission required Microsoft to offer a WMP-less version of Windows, which the Commission later agreed should be called "Windows XP N".

In its appeal to the Court of First Instance (CFI), Microsoft argued that the integration of WMP into Windows simply was not, either conceptually or legally, a tie. Moreover, even if there was (quod non) a tie, the Commission had not sufficiently demonstrated that it had produced any anticompetitive effects by foreclosing competitors. The CFI rejected those arguments and upheld the decision.[2] Microsoft has decided not to appeal the judgment.

This article will discuss the central parts of the Commission's Decision and the CFI's judgment, before analyzing the implications of the judgment from a Community competition policy perspective.

II. The Commission's Decision

Unlike the interoperability part of the Decision, in relation to which the Commission's investigation was initiated following a complaint by Sun Microsystems, the Commission's investigation into WMP was launched on its own initiative.[3] The Commission admitted, however, that the situation did not fit within the model of a "classical tying case".[4] This led to some uncertainty as to the precise legal basis for the Commission's claims. Thus, in its second

1 Commission Decision 2007/53/EC of 24 May 2004, Case COMP/C-3/37.792 — Microsoft, 2007 O.J. (L 32) 23 [hereinafter Decision].

2 Case T-201/04, Microsoft v. Commission (not yet reported) (judgment of Sep. 17, 2007) [hereinafter Judgment].

3 Judgment, *supra* note 2, at para. 10.

4 Decision, *supra* note 1, at para. 841.

Statement of Objections (SO), the Commission had relied on claims that the integration of WMP infringed Article 82(b) and (d). But in the Decision, the Article 82(b) claim was dropped, and the Commission only nominally pursued a claim based on Article 82(d).[5] Rather, its case was primarily based on a general application of Article 82 and the case law (in particular, the *Hilti* and *Tetra Pak II* cases[6]), from which the Commission derived the following test:

> "Tying prohibited under Article 82 of the Treaty requires the presence of the following elements: (i) the tying and tied goods are two separate products; (ii) the undertaking concerned is dominant in the tying product market; (iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and (iv) tying forecloses competition."[7]

That test was, the Commission considered, satisfied by the integration of WMP into Windows.

First, according to the Commission, WMP was a separate product from the Windows operating system itself, since media players are available separately on the market. Consumers can and do obtain other media players such as RealPlayer and QuickTime, as well as WMP itself and WMP upgrades, by downloading them from the Internet. The fact that many consumers expect their PC to include a streaming media player does not, the Commission held, make the two an integrated product for the purpose of the tying test.[8]

Since Microsoft had admitted that it was dominant in the supply of PC operating systems, the second condition was also satisfied.[9]

The third condition was also considered to be satisfied since Windows was distributed with WMP pre-installed. Inevitably, therefore, customers did not have a choice to obtain Windows without WMP. The Commission noted that con-

5 The Decision (*id.* at para. 792) articulates this as a basis; but, there was no claim in the decision that the integration of WMP forced Windows customers to accept "supplementary obligations", nor any suggestion that such obligations would have been inconsistent with "commercial usage".

6 Case C-53/92 P, Hilti v. Commission, 1994 E.C.R. I-667 and Case C-333/94 P, Tetra Pak v. Commission, 1996 E.C.R. I-5951.

7 Decision, *supra* note 1, at para. 794.

8 *Id.* at paras. 800-13.

9 *Id.* at 429 & 799.

sumers were not forced either to "purchase" or to "use" WMP, but regarded this as irrelevant.[10]

Finally, the Commission set out a detailed theory of foreclosure, based on the ubiquity of WMP on PCs worldwide as a result of its integration with the Windows operating system.[11] It claimed that distributors of other media players could not replicate this ubiquity by concluding installation agreements with original equipment manufacturers (OEMs), by offering their media players for download on the internet, or by bundling media players with other software. That in turn would be likely to encourage software developers and content providers to give priority to WMP over other media players, which would create network effects leading to the foreclosure of Microsoft's competitors and the creation of barriers to entry for new products.

On that basis, the Commission concluded that Microsoft had infringed Article 82 by the integration of WMP with Windows.

III. The CFI's Judgment

The Court upheld the Commission's case on the tying of WMP. Starting with the tying test itself, the judgment endorsed the four-stage test proposed by the Commission, with two qualifications. The first was the addition of the condition that there must be no objective justification for the conduct in question.[12] The second was a reformulation of the Commission's customer choice test (no choice to obtain the tying product without the tied product) as an orthodox test requiring the imposition of "supplementary obligations" or coercion within Article 82(d),[13] a claim that the Commission had conspicuously eschewed in its Decision.

Applying that test to the facts of the case, the Court confirmed that WMP was to be regarded as a separate product from the Windows operating system, essentially for the reasons given by the Commission in its Decision.[14] The judgment went on to find that the pre-installation of WMP could be regarded as both coercion and the imposition of "supplementary obligations", on the basis that consumers were unable to acquire the Windows operating system without simultaneously acquiring WMP, and that it was not technically possible to uninstall WMP.[15]

10 *Id.* at paras. 826-34.

11 *Id.* at paras. 835 *et seq.*

12 Judgment, *supra* note 2, at para. 869.

13 *Id.* at paras. 864-65.

14 *Id.* at paras. 912-44.

15 *Id.* at paras. 960-75.

On the issue of foreclosure, the Court confirmed that while neither Article 82 as a whole nor Article 82(d) specifically made any reference to a requirement to demonstrate the anticompetitive effect of bundling, "the fact remains that, in principle, conduct will be regarded as abusive only if it is capable of restricting competition."[16] The Commission was therefore correct to examine in detail the extent to which the integration of WMP did foreclose competitors. In its application of that test, however, the Court again went considerably further than the Decision. It was sufficient, the Court concluded, that the Commission demonstrated that the ubiquity of WMP resulting from its distribution with Windows could not be counterbalanced by other methods of distributing media players. That allowed Microsoft to obtain "an unparalleled advantage with respect to the distribution of its product and to ensure the ubiquity of Windows Media Player on client PCs throughout the world."[17] In turn, that provided a disincentive for users to make use of third-party media players and for OEMs to pre-install such players on client PCs. This, the Court said, "inevitably had significant consequences for the structure of competition."[18] Nevertheless, the judgment went on to endorse the other elements of the Commission's analysis of foreclosure in any event, concluding that the Commission had sufficient grounds to state that there was a "reasonable likelihood that tying Windows and Windows Media Player would lead to a lessening of competition so that the maintenance of an effective competitive structure would not be ensured in the foreseeable future."[19] This conclusion was not, according to the CFI, invalidated by the fact that, several years after the beginning of the abuse, a number of third-party media players were still present on the market.[20] Nor were the anticompetitive effects of the tying objectively justified by the beneficial effects of the uniform presence of media functionality in Windows, such as the provision of a stable platform for software developers and web designers.[21]

IV. Analysis

The analysis that follows considers in turn each of the central planks of the Court's judgment on tying: the separate products test, the coercion test, and the foreclosure requirement. It will show that, on each of these issues, the approach

16 *Id.* at para. 867.

17 *Id.* at para. 1054.

18 *Id.*

19 *Id.* at para. 1089.

20 *Id.*

21 *Id.* at para. 1151.

adopted by the Court is problematic and calls into question the rigor of its review of controversial decisions of the Commission.

A. THE SEPARATE PRODUCTS TEST

At a semantic level it is clear that unless products are separate, they cannot be "tied" to one another. This in itself, however, does not give any guidance as to when products should be regarded as "separate" for the purposes of assessing tying under Article 82. This question was one on which Microsoft and the Commission were fundamentally divided. It is disappointing that the Court addressed at length the factual matters in favor of the Commission's conclusion, without giving any principled answer to the prior question of why the Commission was, as a matter of law, correct in its test.

IT IS DISAPPOINTING THAT THE COURT ADDRESSED AT LENGTH THE FACTUAL MATTERS IN FAVOR OF THE COMMISSION'S CONCLUSION, WITHOUT GIVING ANY PRINCIPLED ANSWER TO THE PRIOR QUESTION OF WHY THE COMMISSION WAS, AS A MATTER OF LAW, CORRECT IN ITS TEST.

Both Microsoft and the Commission were in agreement that the distinctness of products for the purpose of a tying analysis under Article 82 EC had to be assessed by reference to customer demand. The parties disagreed, however, as to what was the relevant customer demand. The Commission took the position that the relevant question was the existence of independent demand for the tied product, in this case WMP or media players in general. By contrast, Microsoft argued that the relevant question in this case was rather whether there was demand for operating systems to be offered without media functionality. Put another way, Microsoft's proposed test was whether there was demand for the products to be "untied".

In order to determine which of the two interpretations is correct, it is necessary to consider the underlying rationale of the separate products test. That rationale has never been discussed in the tying cases which have come before the European Court. It has however, been considered by the U.S. courts, most pertinently in the *Microsoft III* judgment of the U.S. Court of Appeals for the DC Circuit.[22] There, the Court recognized that not all ties are detrimental, and that customers could benefit from tying (e.g., through lower distribution and transaction costs). The Court cited the integration of mathematical co-processors and memory into micro-processors chips, and the inclusion of spell checkers in word processors as examples from the computer industry.

Given that tying may have potentially positive as well as negative effects, the consumer demand test, in the judgment of the DC Circuit Court, is a "rough proxy for whether a tying arrangement may, on balance, be welfare enhancing" (i.e., whether the customer benefits from tying outweigh the customer restrictions):

22 United States v. Microsoft Corp., 253 F.3d 34, 346 (D.C. Cir 2001) [hereinafter *Microsoft III*].

> "In the abstract, of course, there is always direct separate demand for products: assuming choice is available at zero cost, consumers will prefer it to no choice. Only when the efficiencies from bundling are dominated by the benefits to choice for enough consumers, however, will we actually observe consumers making independent purchases. In other words, perceptible separate demand is inversely proportional to net efficiencies."[23]

This proxy is intuitively convincing. If, due to efficiencies, two components can be offered either at a lower price (e.g., as a result of economies of scale) or at better quality (e.g., due to integration), and the restrictions on customer choice are not severe (e.g., because bundling does not prevent the use of alternative components), then one would expect all, or almost all, consumers to buy the components as a bundle rather than separately. By contrast, if the efficiencies from bundling are limited and choice is valued highly, then a significant number of consumers can be expected to buy the components individually. This rationale indicates that the critical question is whether consumers only demand the alleged tying product as a bundle, or whether there is material separate demand for the components.

> THE CRITICAL QUESTION IS WHETHER CONSUMERS ONLY DEMAND THE ALLEGED TYING PRODUCT AS A BUNDLE, OR WHETHER THERE IS MATERIAL SEPARATE DEMAND FOR THE COMPONENTS.

In some circumstances, it is irrelevant whether the separate demand test is phrased in terms of the demand for the two products to be "untied", or simply framed in terms of the demand for the alleged tied product, since both questions lead to the same outcome. This is the case in a tie between consumables and primary products, and explains why the CFI in *Hilti* identified nail guns and nails as separate products on the basis that "there have been independent producers ... making nails intended for use in nail guns"[24]; hence, that there was an independent demand for the tied product, nails. If there is demand for nails produced by independent producers, it follows inexorably that there is also demand more generally for the two products to be "untied".

But the facts of the present case demonstrate that, in some cases, the two questions may have different answers. The particular characteristics of media players are that:

23 *Id*. at 383-84.

24 Case T-30/89, Hilti v. Commission, 1991 E.C.R. II-1439, at para. 67.

(a) they are typically made available for free;

(b) they are relatively easy to download;

(c) they require a minimal amount of memory on a PC; and

(d) they are imperfect substitutes both in terms of features as well as formats.

As a result of these features, many customers have installed and use more than one media player. This in turn means that while there is undoubtedly separate demand for media players themselves, that demand would still exist even if most or all customers wanted WMP to be bundled with Windows. In such a case, the separate products test only corresponds with its economic rationale (as a proxy for the net welfare effect of the arrangement) only if it is asked whether there is customer demand for the "untied" product. The Commission's version of the test, focusing only on the demand for the tied product, carries the risk of producing what scientists call a "false positive".

The CFI's analysis of the separate products test did not, in this author's view, deal adequately with these problems. The Court's starting point was the assertion that the Commission's test was supported by the *Tetra Pak* and *Hilti* cases.[25] But that begs the question, since the CFI did not address the central issue of whether those cases (which both involved ties of consumables) had comparable features to the present case.

The CFI's second argument was that Microsoft's argument "amounts to contending that complementary products cannot constitute separate products for the purposes of Article 82 EC, which is contrary to the Community case-law on bundling." In support, the Court commented that in *Hilti* it could be assumed that there was no demand for a nail gun magazine without nails, since a magazine without nails is useless, but that this did not prevent the European Court there from concluding that the two products belonged to separate markets.[26]

Unfortunately this too misses the point. The question of whether there is demand for a specific product to be made available in "untied" form does *not* lead to the result that two complementary products are inevitably to be regarded as a single product. That is illustrated by the *Hilti* example given by the CFI itself; in that case, while users obviously

THE QUESTION OF WHETHER THERE IS DEMAND FOR A SPECIFIC PRODUCT TO BE MADE AVAILABLE IN "UNTIED" FORM DOES *NOT* LEAD TO THE RESULT THAT TWO COMPLEMENTARY PRODUCTS ARE INEVITABLY TO BE REGARDED AS A SINGLE PRODUCT.

25 Judgment, *supra* note 2, at para. 920.

26 *Id.* at para. 921.

needed to obtain both cartridge strips and nails to use together in their nail guns, there was a demand for cartridge strips to be sold without the corresponding nails (i.e., for the two products to be "untied"). Thus, although the products were complementary, they were clearly separate products.[27] It cannot, however, be assumed that the same is true of Windows and WMP. Ultimately, it should have been a matter of evidence demonstrating the demand for Windows and WMP to be distributed separately rather than together. No such evidence was provided, since the Commission did not regard this as a relevant question.[28]

The Court's third and final argument on the test was a claim that in any event there was demand for client PC operating systems to be provided without streaming media players, for example by companies afraid that their staff might use them for non-work-related purposes, which the Court claimed was not disputed by Microsoft.[29] This is a surprisingly uncritical acceptance of a single-sentence assertion by the Commission in the Decision,[30] which Microsoft did *not* accept; on the contrary, it pointed out in its pleadings that the claim was simply conjecture on the part of the Commission, unsupported by any evidence whatsoever.

The comments of the Court represent little more than a recitation of the arguments of the Commission, with little or no critical analysis. They suggest that the Court was unable or unwilling to articulate a coherent rationale for its approach. That is unfortunate, and Microsoft (and other undertakings in a similar position) would be justified in expecting better. In an industry where product integration is the norm, and where there is increasing consumer demand for multifunctional equipment, the Court's judgment sets an uncertain precedent for undertakings seeking to satisfy that demand.

B. THE COERCION TEST

Having established that two products are properly to be regarded as separate, the central objection to a tie is that customers are coerced into purchasing the sec-

27 One can think of many similar examples: wine and wineglasses or a chocolate fountain and chocolate, to cite a few close to the heart of this author.

28 It follows that the CFI's comments that customers might wish to obtain the products together, but from different sources, were also pure speculation (Judgment, *supra* note 2, at paras. 922-23). Had the Commission asked the right question, it might conceivably have found that end users and OEMs wish to obtain Windows unbundled from WMP, in order that a different media player can be pre-installed (though this seems unlikely, given the negligible sales of Windows XP N). On the other hand, it might have found that the preponderant demand was for the products to be bundled, since it saves everyone the bother of installing WMP, which most users would end up downloading anyway. The point is, however, that the decision simply did not reach a conclusion on this issue one way or the other.

29 Judgment, *supra* note 2, at para. 924.

30 *See* Decision, *supra* note 1, at para. 807 & n. 936 which simply cites in support the fact that "Organisations routinely choose the applications they want installed on their desktops."

ond product from the dominant supplier of the first product, when they would prefer to obtain the second product elsewhere (or in some cases not at all). In the *Hilti* case, the producers of nail guns attempted to force users to purchase only their own branded nails and cartridges for use in the guns. In *Tetra Pak II*, the purchases of filling machines were not able to obtain supplies of packaging from any source other than Tetra Pak. In both cases, therefore, the tie was prohibited because of the coercion of the customers, forcing them to buy from Hilti and Tetra Pak certain consumables that they would or might have wanted to source from a competing supplier.

That objection is reflected in the U.S. tying standard applied in *Microsoft III*, referred to previously, which requires that "the defendant affords consumers no choice but to purchase the tied product from it."[31] This test is thus explicitly based on the notion of a forced purchase, and is central to the U.S. interpretation of the tying test. As the U.S. Supreme Court said in the seminal case of *Jefferson Parish*:

> "[T]he essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer did not want at all, or might have preferred to purchase elsewhere on different terms."[32]

In a similar vein, the U.S. Supreme Court in the earlier case of *Northern Pacific Railway* had defined a tying arrangement as:

> "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[33]

According to the Court, such arrangements:

31 *Microsoft III*, *supra* note 22, at 381.

32 Jefferson Parish Hosp. Dist. v. Hyde, 466 U.S. 2 (1984).

33 Northern Pac. R. Co. v. United States, 356 U.S. 1, 518 (1958)

> "deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market. At the same time buyers are forced to forego their free choice between competing products."[34]

The reasoning of the U.S. Court in these cases is consistent with the judgments in *Hilti* and *Tetra Pak*, the key feature being that the forced purchase of the product from the dominant undertaking deprives the customer of the choice to purchase elsewhere from a competing supplier.

By contrast, the Commission's different test of whether the dominant undertaking "does not give customers a choice to obtain the tying product without the tied product" (a definition subsequently repeated in the Commission's Article 82 discussion paper[35]) was entirely anodyne, containing no requirement of either a forced purchase or coercion of any sort. This test would be satisfied, for example, if WMP did not come pre-installed as part of Windows, but was simply provided with Windows in every case for the customer to install if desired.[36]

The CFI evidently recognized the problems with this approach, and noticeably did not apply the Commission's test. Instead, in its view, the test was indeed one of coercion or the imposition of supplementary obligations within the meaning of Article 82(d).[37] Therefore prima facie, its judgment realigns the tying test with the U.S. jurisprudence and the European Court's earlier case law and is consistent with the basic rationale of a tying prohibition.

The Court's application of this test to the facts of the case is, however, more questionable. As noted above, the CFI's ruling was that the test was satisfied by the fact that consumers buying a Windows operating system automatically obtained WMP, taken together with the fact that WMP could not technically be

34 *Id.*

35 The Commission's Article 82 discussion paper asserts: "Typically tying involves the dominant undertaking by contract depriving its customers of the choice to obtain the tying product without the tied product." *See* European Commission, DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (Dec. 2005) [hereinafter Article 82 discussion paper], at para. 182, *available at* http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf.

36 To take another example familiar to readers of British weekend newspapers, the inclusion with the newspaper of a free CD or DVD would also, on this definition, be regarded conceptually as a "tie".

37 *See,* in particular, Judgment, *supra* note 2, at paras. 961-63 & 975.

uninstalled. Both of these points are correct as a matter of fact. But for the CFI to draw from those facts the conclusion that customers were in some way coerced or required to accept supplementary obligations, in circumstances where the pre-installation of WMP constituted neither a forced purchase,[38] nor a forced use of the product, and did not prevent OEMs or end users from installing and using other media players in preference, is a triumph of form over substance. The Court's true assessment of the situation is betrayed by its comment, in the same part of the judgment, that "OEMs are deterred from pre-installing a second streaming media player on client PCs and ... consumers have an incentive to use Windows Media Player at the expense of competing media players."[39] The integration of WMP might well have acted as an OEM "deterrent" or a consumer "incentive", but neither effect should be regarded as coercion or the imposition of supplementary obligations.

THE INTEGRATION OF WMP MIGHT WELL HAVE ACTED AS AN OEM "DETERRENT" OR A CONSUMER "INCENTIVE", BUT NEITHER EFFECT SHOULD BE REGARDED AS COERCION OR THE IMPOSITION OF SUPPLEMENTARY OBLIGATIONS.

It is difficult to avoid the conclusion that on this issue at least the CFI was (to invert the usual idiom) "willing to strike, but afraid to wound." The Court apparently wished to set a precedent underlining that the tie of two products is only to be regarded as abusive where the "supplementary obligations" condition of Article 82(d) is satisfied; at the same time, however, it seems to have been very careful not to overturn the decision on this point.

C. FORECLOSURE

In light of the increasing discussion, including within the Commission itself, as to the application of a more rigorous economic approach to the interpretation of Article 82,[40] it is encouraging that the Court has reiterated that conduct will only be regarded as abusive where it is capable of restricting competition, and appears to have endorsed the Commission's application of a foreclosure test which takes account of the "actual effects" that the conduct has had on the market.[41]

As with the coercion test, however, the difficulties lie in the Court's application of the test on the facts, for which the Court appears to have relied very heavily on a structural standard. It was sufficient, the CFI thought, that the

38 The suggestion (*id.* at para 968) that the price of WMP is included in the total price of the Windows operating system ignores the fact that the competitive price of WMP is zero, since both WMP and competing media players are widely available to download for free.

39 Judgment, *supra* note 2, at para. 971.

40 In particular in the context of the Article 82 discussion paper, *supra* note 35.

41 Judgment, *supra* note 2, at paras. 867-68.

Commission demonstrated that the integration of WMP "inevitably had significant consequences for the structure of competition," by allowing WMP to benefit from the ubiquity of Windows on PCs throughout the world.[42] According to the CFI, it was not necessary to go further and show that this did in fact result in the elimination or restriction of competition, as the Commission had done in its examination of the network effects said to result from Microsoft's conduct.

The CFI thus seems to be saying that the use by Microsoft of a particularly effective distribution system for its media player in itself constituted foreclosure, whether or not the evidence showed an overall reduction of competition on the media player market (e.g., by a reduction in the number of media players available or a trend towards exclusive use of WMP). Indeed, the Court expressly commented that it was common ground that the number of media players and the extent of the use of multiple players are continually increasing. But this did not, in the Court's view, demonstrate the absence of foreclosure.[43]

The Court's judgment on this issue gives rise to a number of questions. First, the ruling is at odds not only with the methodology of the Commission in its original decision, but also the approach adopted by the Commission in its Article 82 discussion paper. In the latter, the Commission emphasizes that the *Hoffmann-La Roche* definition of exclusionary abuse within Article 82 requires a "likely market distorting foreclosure effect" to be established. It goes on to say that:

> "By foreclosure is meant that actual or potential competitors are completely or partially denied profitable access to a market. … Foreclosure is said to be market distorting if it likely hinders the maintenance of the degree of competition still existing in the market or the growth of that competition and thus have as a likely effect that prices will increase or remain at a supra-competitive level."[44]

Whatever Microsoft's criticisms of the Commission's own foreclosure assessment, it is clear that that assessment was designed to satisfy a test of foreclosure akin to the test articulated in the discussion paper. The judgment of the CFI, however, does not even purport to follow this approach. It is unclear where this leaves the Commission's Article 82 policy reform proposals, for which the eco-

42 *Id.* at para. 1054.

43 *Id.* at para. 1055.

44 Article 82 discussion paper, *supra* note 35, at para. 58.

nomic analysis of foreclosure proposed in the discussion paper was a central tenet. The legal formalism of the CFI's approach in this case in respect of Article 82 is also inconsistent with the European Court's own emphasis on a more economic approach to the assessment of anticompetitive effects in the fields of Article 81 and merger control,[45] prompting the question of why Article 82 should be treated differently.

From a purely practical perspective, the CFI's judgment is also likely to create real problems for dominant undertakings. Many such undertakings will benefit from particular advantages which may make their products or services particularly attractive to, or more likely to be used by, consumers. That in itself should not imply foreclosure. Rather, the real question should be whether the use (or abuse) of those advantages leads in concrete terms to a lessening of competition on the market. For those advising undertakings in this situation following *Microsoft*, there is no longer merely the (already difficult) question of considering whether their competitive conduct falls the right side of the line; rather, there is a real question of what the line even looks like.

V. Concluding Remarks

Some critics of the *Microsoft* judgment have pointed in mitigation to the unusual facts of the case and the constitution of the Court delivering the judgment. Not many dominant undertakings, it is said, enjoy the ubiquity of the Windows operating system and the competitive advantages that entails. Moreover, it is pointed out, one cannot expect ground-breaking judgments from a Grand Chamber of 13 judges from very different legal traditions. In this author's view, neither of these factors is a good excuse. The size, strength, and market power of an undertaking are all relevant factors in the economic assessment of an alleged infringement of Article 82; however, they should not lead to the adoption of a different or lower threshold for the establishment of such an infringement. And if the Grand Chamber of the CFI is unable to deliver a coherent and principled judgment in an important case, serious doubts must be raised as to the usefulness of such a constitution.

THE *MICROSOFT* RULING SHOULD BE SEEN FOR WHAT IT IS: A CLEAR SIGNAL THAT THE CFI IS ITSELF UNWILLING TO ACT AS A CATALYST FOR THE REFORM OF ARTICLE 82 POLICY.

The *Microsoft* ruling should therefore be seen, unexcused, for what it is: a clear signal that the CFI is itself unwilling to act as a catalyst for the reform of Article 82 policy. But that does not prevent reform from taking place, as it is doing,

45 *See, e.g.,* Case T-342/99, Airtours plc v. Commission, 2002 E.C.R. II-2585; Case C-12/03 P, Commission v. Tetra Laval, 2005 E.C.R. I-987; Case T-210/01, General Electric Company v. Commission, 2005 E.C.R. II-5575; Case T-328/03, O2 (Germany) v. Commission, 2006 E.C.R. II-1231; Case T-168/01, GlaxoSmithKline v. Commission (not yet reported) (judgment of Sep. 27, 2006).

through the Commission's own development of its policy in the prosecution of Article 82 cases. In that respect, there is as yet no sign that this judgment (or the equally controversial judgment of the ECJ in *British Airways* earlier last year[46]) has dissuaded the Commission from an economic analysis in its investigation of ongoing Article 82 cases. In fact, if anything, the *Microsoft* judgment demonstrates the need for an ongoing debate as to the direction of the Commission's enforcement policy in this area. It is to be hoped that the legal uncertainty resulting from the ruling will at least serve to reinvigorate that reform process.

46 Case C-95/04 P, British Airways v. Commission (not yet reported) (judgment of Mar. 15, 2007).

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Economic Analysis of Competition Practices in the EU and the U.S.: A View from Chief Economists

Dennis Carlton and Michael Salinger

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Economic Analysis of Competition Practices in the EU and the U.S.: A View from Chief Economists

Dennis Carlton and Michael Salinger

On February 21, 2007, the Jevons Institute for Competition Law and Economics at University College London hosted its Annual Antitrust and Regulation Forum. The forum covered two broad topics: the relationship between antitrust and regulation and the use of an effects-based approach.

We are privileged to reprint the remarks made by Dennis Carlton, who was then Deputy Assistant Attorney General for the Antitrust Division of the U.S. Department of Justice, and Michael Salinger, who was then Director of the Bureau of Economics at the U.S. Federal Trade Commission), as well as those by Amelia Fletcher, Chief Economist of the U.K. Office of Fair Trading, who moderated the discussion. (The event was recorded and the remarks were transcribed; very few of their words have been altered to preserve the integrity of the conversation that day.)

On behalf of the Jevons Institute and *Competition Policy International*, I would like to extend my sincere thanks to Amelia, Dennis, and Michael for their time and excellent contributions.

David S. Evans
Executive Director, Jevons Institute for Competition Law and Economics
Editorial Board Chair, *Competition Policy International*

This article is a transcript of the presentations given by Dennis Carlton and Michael Salinger at the University College London's Annual Antitrust and Regulation Forum held on February 21, 2007 and hosted by the Jevons Institute for Competition Law and Economics. At the time of the event, Dennis Carlton was a Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice. He is currently Professor of Economics at the University of Chicago. At the time of the event, Michael Salinger was the Director of the Bureau of Economics at the U.S. Federal Trade Commission. He is currently Professor of Economics at Boston University School of Management. The views expressed here are their own and do not necessarily reflect the views of the agencies with which they were, or are now, associated.

EVANS: I'm David Evans and on behalf of the Jevons Institute for Competition Law and Economics at the University College London [UCL], I'd like to welcome you to the 2007 edition of the UCL Antitrust Forum. This is our third forum in the last three years. This evening we're going to be discussing two broad topics. The first is the relationship between antitrust and regulation, and the second is effects-based approaches and when a business process should be deemed anticompetitive. We really couldn't have a better group of individuals to debate those subjects.

Tonight's topics are quite far-flung. They're part of a very vibrant discussion on the purpose and practice of competition law that's raging these days on both sides of the Atlantic. Yesterday, the U.S. Supreme Court issued its opinion on predatory bidding, and one of the four antitrust cases that has taken this term, and that's a record for the U.S. Supreme Court, which takes one about every five or ten years. So it's really quite a record this year.

In addition, both the U.S. Congress, through the Antitrust Modernization Commission, and the U.S. enforcement agencies have been holding very detailed hearings on core issues and antitrust. In Brussels, we await the next version of the Article 82 Discussion Paper, and likely much more. Alas, in Luxembourg we're still awaiting the *Microsoft* decision, which likely will address all sorts of important topics in the law on abusive dominance.

Now these topics could really carry us through the night, but this evening we're looking to Amelia in a role that the U.K. Office of Fair Trading [OFT] is very good at, as a regulator, and she'll use her full powers. So with that, I'll turn it over to Amelia, who is going to be moderating our program this evening.

FLETCHER: Thanks, David. I should probably start by disputing that the OFT is a regulator. That is not how we see ourselves. Now, it is very exciting to be here on the platform with these influential chief economists, particularly given their previously formidable reputations as academic economists as well.

David has already explained the two issues that we are going to be covering. The first is on regulation and antitrust, and the complementarities between those two areas of policy, and the tensions and the policy implications of those complementarities and tensions. It will be very interesting, given that the approach taken in the U.S. is very different to the approach taken in the U.K., and that there are differences within the EC member states as well. So it will be interesting to get that transatlantic perspective.

The second session is going to be on effects-based approaches, incredibly topical here for various reasons, but including the Article 82 Discussion Paper and the debate around that. Also in the U.S., given the work of the Antitrust Modernization Committee and recent movement on issues such as price discrimination and RPM [resale price maintenance].

With that, I will turn it straight over to Dennis, who starts the first session.

CARLTON: Thank you very much. It's a pleasure and an honor to be here.

Let me start with a disclaimer. My views here are only my own and don't necessarily represent those of the Department of Justice. I'm going to start with some remarks about antitrust and regulation that are based on a paper that I've written with a colleague at the University of Chicago, Randy Picker, and that paper, entitled "Antitrust and Regulation" [forthcoming in *Economics of Deregulation* (N. Rose ed., Nat'l Bureau of Econ. Res.)] is focused on the U.S. Obviously I will be quite interested in hearing about the EU's experience and talking about that more.

Antitrust and regulation can be viewed as two different mechanisms to control competition. They can be viewed as substitutes in that either one can be the mechanism by which you try and control and limit the way firms compete against each other. But more recently, at least in the United States, we've seen that antitrust and regulation can be used as complements in which you use antitrust as a restriction on what regulators can do.

In the United States, the main regulatory and antitrust institutions were created at about the same time. The Sherman Act was passed in 1890, and the Interstate Commerce Commission was formed at about the same time, 1887. It was a time when the U.S. economy was going through dramatic changes in structure, and people, quite frankly, were unsure how in the world to rein in some of these large trusts that were being created.

In the United States, within the last 40 years, antitrust has gotten much better and has become economically coherent. I think the implication of this has been that there's been a dramatic move away to rely on regulation as a method of controlling competition. There's been, in those industries where it's recognized you still need regulation, a complementary use of antitrust and regulation in order to take advantage of the comparative advantages of each. I'll also talk a little bit about what the Antitrust Modernization Commission is likely to say about that as I am one of its Commissioners.

Let me start out from a theoretical basis. What are some of the different properties you can expect between regulation and a general antitrust statute, from a theoretical basis? The first point to begin with is that there's a literature in political science, using game theory and principal agent theory, in which you try and figure out what are the different attributes of regulation versus antitrust.

Imagine there's an industry that wants to get some law passed that's favorable to it, and it's wondering about how the law will be enforced over time. Well, the industry could say to the legislators "construct a regulatory agency," because if it does that, then once it's established, if the regulatory agency starts deviating from the original intent that the industry had in inducing legislators to set it up, it can go back to them and tell them, influence them, to reappoint regulators, different regulators, and get them on track.

Now this ignores the fact that in order to get a regulatory agency or legislation passed, you need a consensus among different political groups. And those political groups may understand that if a regulatory agency is constructed, once its set up there can be regulatory drift. That is, the regulatory agency might start pursuing policies different than what the industry, or say the Congress, wanted to achieve when you initially vote for the regulation. The industry might say to itself, "once that regulatory agency is established it's going to be a) hard to get it abolished, and b) I might not have enough influence to alter who the regulators are." And, therefore, "in order to avoid regulatory drift, maybe what I want is, instead of a regulatory agency, I want to construct a law that will get administered by judges who are more immune from political pressure." Those are sort of the tradeoffs between regulation and antitrust.

But there are other properties that distinguish regulation from antitrust. Regulatory decisions are typically coordinated across one point in time. If I'm regulating the railroads, I can introduce a regulation that will affect the entire industry at a point in time. Across time, as different political regimes come in and appoint new regulators, there could be a lack of continuity of policy.

The courts, in contrast, are the reverse. Court decisions in the United States will apply to local jurisdictions and to the local parties bringing the decision. Over time, maybe they'll converge as the U.S. Supreme Court takes on cases, but generally courts are not coordinated at any one point in time, though they may achieve coordination ultimately over time.

Regulators are also proactive. They can do something if a problem arises. Courts, on the other hand, are reactive. They can only do things if someone brings it to their attention. What that really means is, if you're thinking about a network industry, like railroads for example, and you had to guess: "Am I going to apply the Sherman Act or a regulatory scheme?" Then you would say: "Gee, I need coordination across railroads, they have to interconnect with each other and therefore I am going to regulate them." Regulation requires specialized knowledge that gets accumulated. Courts don't have that. Regulation reflects social values, which a court really is not set up to reflect. So how much do you value safety? How much should the rate of return be so that you can provide a safe product or a product you like?

Regulation is often a compromise among competing interest groups, consumers plus producers. That means that if an industry is really strong and powerful, it won't get a regulatory agency established, because a regulatory agency may have to pay attention to consumers. Instead, it will get an exemption from the antitrust laws with a bar to rivals entering, and we've seen that in the United States.

Let me turn briefly to the history. What does history tell us? It turns out antitrust, as I said, was a hot political topic around the turn of the century. It was the subject of presidential debates as to what the proper antitrust policy should be. Initially, Theodore Roosevelt wanted a regulatory-type agency that he would be able to call upon to regulate an industry, and if there was a problem he could try and fix it. That ultimately manifested itself in the passage of an act in 1914 that established the U.S. Federal Trade Commission. The Federal Trade Commission did not turn out to be the regulatory agency that industry thought it would become and which they could control. In 1914 the Clayton Act was enacted. The Clayton Act made more specific to the court what exactly were the violations of the antitrust law.

In terms of the different properties, what we found is that network industries did tend to get regulated. Regulators generally were not very good at efficiency, and in most regulated industries we saw cross-subsidies from one group of consumers to another. Excess labor was employed, and in terms of technological change it was often impeded. In order to engage in a cross-subsidy, you often had to have entry restrictions. The entry restrictions protected incumbent firms. In antitrust we saw that when courts tried to regulate prices they didn't necessarily do a very good job because they lacked the experience. Behavioral remedies, imposing a duty to deal, may not be particularly effective unless one continuously sets a price at which a firm must deal.

In the mid 1970's, to quote Judge Posner, the antitrust laws were "an intellectual disgrace." What we saw is a movement in the last 30 or 40 years, as antitrust got better, away from regulation to antitrust. For the deregulated industries, we generally saw lower employment, wages falling, cross-subsidies ending, and massive horizontal and vertical consolidation. In the U.S. Supreme Court's recent *Trinko* decision [540 U.S. 398 (2004)], we saw that the courts, I think correctly, said there was no general duty to deal under our antitrust laws. Antitrust is ill-suited to regulating duties to deal at a fixed price. And now you can view antitrust as a way to constrain what regulators can do. For example, if there's a merger case, you can require that the antitrust authority have the ability to stop regulators from approving an anticompetitive merger.

I mentioned I'm on the Antitrust Modernization Commission. One of our recommendations is going to be that you should only allow regulators to be affecting the competitive environment when that turns out to be necessary in order for them to pursue whatever are the other social goals that Congress deemed appropriate when they were set up.

Right now in the United States there is something called an antitrust savings clause, which means that you're subject to the antitrust laws. This turns out to be something that, I think, is desirable because it means the antitrust laws can be constraining, not only what firms do, but also what regulators are doing.

Just to sum up regarding competition policy, I think what you want to do is, you want to constrain regulation to only those areas where you think competition won't work. And when you're doing that, you have to explain whether those areas require that the regulators have the ability to use profits from, say, the creation of market power to achieve their objectives. If they don't, then there's no need to, for example, give them authority over mergers. And if there's no need for that, you can rest that with the antitrust authorities.

The question I would like to end with is, whether the relative use of antitrust and regulation in the United States—as it's evolved over time and in particular as antitrust has improved, causing a greater reliance on antitrust—is the appropriate policy for Europe and the rest of the world. And that, of course, depends on the comparative advantage of regulation versus antitrust. Thank you.

FLETCHER: Thanks. [...] Let's turn to Michael, who is going to talk about two particular U.S. cases of interest.

SALINGER: Thank you. As I'm going to begin in a somewhat offbeat way, I'd better get in the disclaimer that what I say today does not reflect the views of the Federal Trade Commission or any of the individual Commissioners.

Amelia promised me that you would all know who Dennis the Menace is. I hear some laughs, so you do. It's a comic about an impish five-year-old boy. My favorite Dennis the Menace strip is one where Dennis is talking to his father and he asks his father what causes the tides. His father says, "the moon." And Dennis says, "I don't believe that." His father says, "what do you think causes the tides?" And Dennis says, "I think there's a whale in the middle of the ocean, and the whale flicks his tail one way and the tide comes in, the whale flicks his tail the other way and the tide goes out." And Dennis' father says, "you don't really believe that, do you?" To which Dennis replies, "no I don't, but it makes a lot more sense than the moon."

Now I recount this story because the concept that it's the moon that causes the tides is a little bit like the concept that we should basically have faith in the outcome of competitive markets. That's a very abstract concept and one that a lot of people struggle with. And it's not just impish five-year-old boys who struggle with it, but the public at large struggles with it and the politicians who represent them struggle with it.

As you think about the relative use of antitrust and regulation, it's important to keep in mind, I think, that we come at this with some basic faith that the competitive outcome is usually the outcome that we want, but that it is sometimes a very tough sell.

I thought I would talk about these ideas with respect to two very specific examples that I've had to deal with in my time at the Federal Trade Commission [FTC]. One is gasoline prices. This is an industry where, as a matter of economics, you would think that antitrust would work pretty well and that you wouldn't need all that much in the way of antitrust intervention. At least in the United States, if you look at the industry nationally, it's a pretty competitive industry. That's not to say that if you look at particular regions and particular levels of the industry, that things might not be a little more concentrated than ideally you would like. That's why the FTC has forced divestitures in a variety of the mergers that we've seen. Yet, there's still a great distrust that the outcomes we see are competitive outcomes and there's something efficient about them.

Whenever prices go up significantly, Congress asks the FTC to study why. Indeed, sometimes when prices go down, Congress asks it to study why they did not go down earlier or faster. These inquiries by themselves are not economic regulation. These inquiries do have value because the public needs to have its faith in the competitive process reaffirmed and it needs to know that there's someone in the government looking after the industry. Given how important the industry is, of course, we shouldn't just assume that the industry is behaving competitively. We do need to continue to check up on it.

But as the FTC is asked to study each ebb and flow of prices, I worry that we're getting closer to regulation than anyone thinks we are. Indeed, behind the request for these inquiries is a veiled threat that we might get some sort of regulation. It is quite plausible that Congress will pass federal price gauging legislation that is similar to laws already enacted in several of the individual states.

The mere threat of this regulation has some of the undesirable consequences of regulation. We want companies to be thinking about how they can hold supplies and deliver them to places that have shortages. Now just as we don't rely on the benevolence of the butcher, the baker, and the brewer for our evening meal, we can't rely on the benevolence of the oil companies to deliver petroleum products to areas that have shortages or in times of shortage. We should expect them to do that because there will be a profit opportunity to exploit. But if there's a threat that we're not going to let prices rise to the level that they need to, to provide that opportunity, then we're not going to see the sorts of supply responses that we need in order to ameliorate or alleviate whatever shortages arise.

The other example I wanted to talk about tonight is the debate that's raging in the United States about so-called net neutrality. If you think people are skeptical about the benefits of the competitive outcome with gasoline, which is a pretty unconcentrated industry, imagine the lack of faith in the competitive outcome in something like the Internet. This is surely a harder problem than the problem with the gasoline industry.

Right now, many American homes have access to high-speed Internet service from two providers. They can get DSL service from the telephone company or they can get high-speed access from the cable company. There are prospects one hears of electricity companies getting into the business. There are various wireless solutions that might materialize, but we need to, I think, entertain the notion that we're going to have competition among two providers, at least in a lot of areas for a significant period of time. This raises a host of issues, including: Are Internet access providers going to be allowed to charge differentially for different kinds of services? Are the Internet access providers going to be able to block certain kinds of service? Are the Internet access providers going to be able to provide content themselves? These all interact because the concern is if they're allowed to provide content themselves, then they're going to charge differentially high pricing for their competitors and they're going to try and block the content of their competitors.

So this is a problem that you can imagine trying to solve in a regulatory fashion, setting up some rules ex ante. Or you can say, "Well, we think we've learned the lessons of the past from regulation." The deregulation movement in the United States that started in the 1970's, arose largely because of the recognition that economic regulation is often highly inefficient. It's particularly inefficient in industries where there's a prospect of rapid technical change. So should we just let competition play out, not regulate, and then rely on antitrust should problems arise? I think the answer to this question depends in part on what sort of errors you're going to make, because we're not going to get this policy perfect.

Antitrust is inherently a softer kind of regulation. It is true that once you get a case, it can become very heavy-handed. But in antitrust cases, if you're going to bring an action, you do have to actually show that the company violated the law, that there is some line that was crossed. So there's a presumption that what the company has done is okay unless you can prove otherwise. With antitrust, there's a greater risk of what the decision theorists call false negatives. That is, that we might let through some sort of anticompetitive behavior.

On the other hand, if you go with regulation, then there's a greater risk, I think, of chilling pro-competitive conduct. I'll give you one specific example, which is this issue of whether or not you can charge differentially for different kinds of access. Some kinds of Internet applications—like voice and some kind of video applications—are time-sensitive. Other kinds of access—like email—aren't. You want to get your email pretty quickly, but it doesn't have to be instantaneous the way a voice conversation has to be. We've lived in a world where the Internet hasn't been capacity-constrained, so that hasn't been much of an issue. But people tell us that it's going to become an issue.

If we rely on ex ante regulation, there are going be pressures to limit the extent to which companies can charge differentially for the kind of access. And if they restrict that, then we're going to get congestion. We're going to get congestion because people overuse the high-quality service, and we're going to get congestion because we're going to limit the incentives to invest in the capacity needed to deliver the high-quality services.

I started with Dennis the Menace, which might seem too unsophisticated for an audience of this sort, but I believe you can find an analogy between economic forces and the effect of the moon on tides in the works of Alfred Marshall. To build on that analogy, if you're in the business of regulating economic activity, either as antitrust enforcers or as sector regulators, it's important to recognize that there are market forces beyond your control. Now if you think of an economic sector as being a boat on the ocean in proximity of a whale, it might be affected by movements of the whale. So if you think of regulators as being the whale, the first challenge is to make sure that you don't capsize the boat, something that can be very hard if you're in turbulent seas, that is if you're in a market environment that is changing rapidly. If you can manage to avoid capsizing the boat and you can help the boat along its desired path, then so much the better. With that somewhat strained analogy, I will sit down. Thank you.

FLETCHER: Thanks. I hope that Dennis the Menace is not related to anyone on this panel. I thought the point that was just made, particularly about the balance between false positives and false negatives, was a very interesting one. We have to recognize that a lot of what firms do is pro-competitive. Firms have to be recognized for making pro-competitive choices, taking risks. The competition authorities, although it's very hard to admit it, inherently will sometimes get things wrong. As such, we do veer towards relatively hands-off policies and we will occasionally let through false negatives. Now, if you're trying to open up a previously nationalized market to competition, you might actually want to veer the other way. You might actually not want to worry about false negatives so much. You might want to be very proactive about encouraging competition.

[...]

SALINGER: A comment on your original question about whether if you have a former state monopoly do you somehow want to jumpstart the competition. We in the U.S. had less experience with that. Probably the closest analogy in the U.S. is with the telephone sector and I don't know if Dennis agrees with me, I think the consensus in the U.S. is that the jumpstarting of competition in the long distance sector was a success. But the attempt to deregulate the local telephone exchange was much less of a success.

What happened was because there were these different components of telephone service the U.S., Congress, and then the FCC [U.S. Federal Communications Commission], tried to set up the system where you could compete by buying a lot from the incumbent. It was billed as a deregulatory approach but in fact it just made the regulation much more complex because instead of just regulating the price to the final consumer you were regulating all of these individual wholesale components. It was done in the name of jumpstarting competition, but it was done in such a way that it really eliminated a lot of the incentive to invest in facilities by new entrants. I would think that the same issues would arise often when you're deregulating a state-owned entity.

CARLTON: It seems to me there's a difference between privatizing versus privatizing and then setting up competition through structural separations or structural dismemberment of the previously regulated monopoly. I think there have been studies—there's at least a survey in the *Journal of Economic Literature*, where they talk about the difference between privatization and privatization combined with competition. There's no question that privatization combined with competition produces much greater gains in productivity than simply privatizing.

Given that you have engaged in some sort of structural dismemberment of a previously regulated national monopoly, and assuming it's not a natural monopoly, it's not obvious to me you want to be intervening more. It seems to me that what you certainly want to do is set up safe harbors where certain activities are immune, both in a regular industry as well as in this newly created industry. So if you do things, you don't have to worry that you're going to get dragged into court. In our *Trinko* decision, the Supreme Court made a very sharp line between a regulated activity and an activity subject to the antitrust laws. I am wary of the ability of the antitrust authorities to set prices and that's what you have to do if you created duties to deal.

In the environment of network industries, if you start deregulating and you don't totally deregulate but you have a network industry in which you need interconnection pricing, then it is clear to me that you don't want an antitrust judge, or a judge in a general court, to try to figure out what that price should be. It seems to me you do want a regulatory agency, at least as regulatory agencies are structured in the United States, to set prices when those prices have to be set. Otherwise it seems to me that you're taking big risks.

Now if the regulator's doing an awful job and in the scheme of things the judges aren't doing as terrible a job as the regulator, you know, maybe that's a stop gap, but I worry about it. I think we would probably agree the right way to fix the problem is to try and fix the regulation, not to try and deal with it through antitrust. Although, if you have no other alternative maybe you have to use whatever tools you have available.

Energy policy in Europe is actually very interesting. Today an issue at the OECD [Organisation for Economic Co-operation and Development] is energy security. When you're talking about regulating a network industry, and the network industry spans national boundaries, then I do think you have this spillover problem and you have to have coordination to deal with it, otherwise you can't deal with it and there's a problem. This happens in the United States also. In energy regulation, how do you create the right incentives for transmission investment? This is really a hard problem, and they have that as a really hard problem in the United States. In Europe, in general, there's this separate issue of: "Are we really one group or if I have a transmission bottleneck should I use that to basically tax the rest of the European countries where I would just capture the rents?" There is a difference between regulating Europe as your objective versus getting wealth for the particular country that's lucky enough to have the bottleneck. That strikes me as a really hard problem.

I would point out that you actually have a very similar problem in the United States if you look at our individual states. Under the state action doctrine, a state can do something like allow a group of farmers to get together and determine how many raisins to produce and then those can be exported to the rest of the United States. (Since I'm not a lawyer I'm always hesitant to specify what a legal principle is because I always find economists don't quite get it right, but I'll take that risk.) There's a case, *Parker v. Brown* [317 U.S. 341 (1943)], in which that behavior is allowed because raisins are produced in California and therefore it's a state action. Consumers consuming raisins in California consume a lot of raisins so therefore if the state legislature wants to allow it, it's okay.

Of course raisins are consumed elsewhere and you have a similar type of spillover and the question is: How should you deal with those spillovers? I don't think there's an easy answer. There has to be some overriding mechanism to constrain how one state can take advantage of other states in the United States and I don't think we have such a great mechanism right now. It can be improved. It's one of the things the Antitrust Modernization Commission is going to look at. But in Europe, where it's also in a regulatory setting, I could see how it's a more severe problem.

[...]

FLETCHER: Thanks very much. We'll go straight on to the second session which is on effects-based approaches to antitrust. So we are leaving regulation behind now.

[...]

SALINGER: Last fall there was a session at the American Bar Association fall forum titled "Monopolization and Abuse of Dominance, with the U.S. and the EU Both Contemplating New Approaches, Will the Best One Win?" Now I found that to be an interesting title.

In the U.S., the closest thing that we have to your [the United Kingdom's] rivalry between Oxford and Cambridge is the rivalry between Harvard and Yale, who compete against each other both intellectually and on the athletic fields. The annual game between them in what we in the U.S. call football used to be quite a big event. Legend has it that many years ago—back in the days when telegrams were the fastest form of written communication—the Yale team the night before what they immodestly call "The Game", capital "T", capital "G", sent a telegram to the Harvard team saying, "May the best team win." To which the Harvard team responded with a telegram of its own saying, "May the better team win." The point of course is that best refers to the top-ranking among three or more possibilities, whereas better refers to the ranking between two alternatives.

The reason I tell the story is that one asks, "Well, will it be the U.S. approach or the European approach that wins out? Or will it be a form-based approach as opposed to an effects-based approach that wins out?" But there aren't just two of these approaches. There's at least a third approach, which is the structured rule of reason. We don't talk about forms-based versus effects-based so much in the U.S., but the distinction seems to be similar to the distinction between per se rules and the rule of reason.

As I'm sure you all know, we've largely backed away from per se rules, except that the per se rule against price-fixing persists and market allocation scheme, that persists and is uncontroversial. But we have two legacy controversial per se rules, both of which may disappear soon. One is the per se ban on maximum resale price maintenance. As I'm sure many of you know, the Supreme Court has accepted the *Leegin* case [127 S. Ct. 2705 (2007)], which will require it to revisit that rule. We, of course, don't know how that's going to turn out, but certainly there's a lot of speculation that if the Court weren't anxious to overturn the per se rule, it wouldn't have granted a writ of certiorari in the case.

The other per se rule that persists is the per se ban on tying in certain circumstance. The Court limited the scope of that rule last year on the *Independent Ink* case [547 U.S. 28 (2006)] when it ruled that in the ownership of a patent, the tying good does not create the presumption of monopoly power needed to trigger the per se rule. It did not overturn the per se rule altogether, but some read the wording of the decision to suggest that it might do so when the opportunity arises.

Getting rid of the per se rules on RPM and tying will be a positive development in U.S. antitrust law, but by itself, the switch to a rule of reason will create its own problems. We have to figure out how we're going to conduct this rule of reason. The per se bans against these practices were formulated at a time when we did not understand as well as we do now some of their pro-competitive uses. But while we do understand the practices better than we used to, it overstates matters considerably to say that we now completely understand their use and that we know exactly how to tell when they are pro-competitive and when they are anticompetitive.

Last fall I was asked to speak about the legacy of the *Matsushita* decision [475 U.S. 574 (1986)]. The United States Supreme Court decided *Matsushita* twenty years ago, so it was a big anniversary. It was a landmark decision in the U.S. in large part because it laid out a key role for economics. What I said about the *Matsushita* decision last fall was that you can read it as implying two quite different roles for economics antitrust, and it relates to this issue of the structured rule of reason versus an effects-based approach.

One possible reading of the decision is that on a case-by-case basis you have to try to understand whether the case makes economic sense. You have to come up with a model for each case. But there's quite another reading of the decision, which is that the role of economics is to help inform somewhat more formulaic rules. And these are rules that would be based explicitly on a recognition of the risk of error. In several recent Supreme Court decisions, including *Matsushita*, *Brooke Group* [509 U.S. 209 (1993)], and yesterday's *Weyerhaeuser* decision [127 S. Ct. 1069 (2007)], a judge has stated priors. The *Weyerhaeuser* decision begins by essentially saying that this is the kind of conduct which is normally competitive conduct and we don't want to take the risk of chilling that kind of behavior.

So with these abuse-of-dominance kinds of issues in the U.S., we have a bunch of these inappropriate per se rules in place, and the form-based approach in Europe probably has comparable inappropriate rules. But it's not clear that we want to go all the way on a case-by-case basis to trying to understand the effects. One of the criticisms I've heard of the Discussion Paper is that you are going to have economists running rampant. As much as I think it would be in some sense a good thing to have economists running rampant, I would have to say that there is a real risk of that.

I think what we might see emerging is this more structured rule of reason. I don't think it's going to be a new set of per se rules. I think we've learned that if you put the wrong per se rule in place, that it could take a very long time to get rid of it. It will materialize as a set of practices which are inherently suspect, but where you can rebut the presumption that under certain circumstances they're illegal. And likewise, you're going to have some safe harbors on the other side—that is practices that are presumed usually competitive, but that are also sometimes rebuttable.

Now one of the problems when you try to establish safe harbors is that, if it's a really safe harbor, there is a reluctance to make it very big. So I wonder whether it would be a good idea, instead of having safe harbors, we'd have pretty safe harbors. The advantage of pretty safe harbors is that, as the antitrust agencies try to articulate what are the structural conditions under which you fall into this, that you would have a more relaxed set of structural standards if you made them pretty safe instead of completely safe.

One of the questions we often get is, "If we agree on consumer surplus as the objective of antitrust, and if we agree on a use of economics, is policy in the U.S. and Europe going to converge?" I think it will converge somewhat, but I don't think we're going to get all the way there, and there are a couple of reasons for that. My sense is that in the U.S. there's more of a concern with the false positives, the concerns that our rules will chill competitive behavior, than is the case in Europe. There's been discussion about the impossibility of having measures of the relative frequency of pro- and anticompetitive uses, so that you have to rely on so-called ideology. I would call them prior beliefs. There's really no way around that. There's great value, I think, in trying to articulate what your prior beliefs are, because in articulating them, you might actually find that you get some convergence.

In Europe, there's also a greater willingness to consider what are sometimes called dynamic effects, but which from a different perspective might be termed uncertain future effects. As a professional economist, perhaps you might think I'm bound to endorse the dynamic standard rather than the merely static standard. But I would caution that the use of the word "dynamic" in antitrust is akin to the use of the word "fair" in international trade. Whatever legitimate role the terms have, and they both have legitimate roles, they pose the risk of being misused to support restrictions on competition.

Given those differences in perspectives, both on the role of dynamic long-run versus short-run effects and the relative tolerance for false positives and false negatives, I don't think we're going to get complete convergence. I do hope that both jurisdictions will have learned that you can mess things up for a long time if you lock yourself into too rigid a policy. I hope rather than having rules that are stated as per se rules, that we'll have these somewhat more flexible standards that will allow the presumptions embodied in the standards to be rebuttable.

FLETCHER: Thanks. Now I'd like Dennis to talk about a couple of areas where the ideologies or prior beliefs are changing, and where there seems to be a bit of a move away from these per se rules.

CARLTON: Well, I have several responses and reactions, and if I have enough time while I'm talking, I'll give them. If not, during the discussion.

What I wanted to talk about were rules aimed really at pricing under the antitrust laws, and see how those types of non-vertical policies have emerged and what we think about them. I mentioned that I'm on the twelve-member Antitrust Modernization Commission, which is a Congressional Commission that was charged with answering the question: "Does antitrust need to be modernized?" We're about to issue our report within the next few months and we have several recommendations. The one I want to talk about is our recommendation to repeal our [the U.S.] Robinson-Patman Act. The Robinson-Patman Act was an amendment in 1936 to our Clayton Act, and it basically forbids price discrimination where the effect is to essentially harm competitors. The law was passed with the strong support of small stores, grocery stores mainly, who were worried about A&P [U.S.-based grocery store] and A&P's buying power. The defense in a Robinson-Patman case is that your price differentials are cost-justified.

Now it's true that while we haven't had a lot of Robinson-Patman cases recently, they, one, impose costs on firms and, two, give firms an excuse not to discount. There have been studies of the Robinson-Patman Act, and what they basically conclude is that it is an act that inhibits discounting to large stores, and therefore prevents the large stores from lowering their prices, with the effect being that consumers wind up paying higher prices.

Other commissions have recommended repeal of the Robinson-Patman Act, and Congress has not listened. Whether they will listen to us, I have no idea. But there's another suggestion the Commission has heard, that I think is just as good, or maybe almost as good. And that is if we can't get repeal of the Robinson-Patman Act, then it should be a requirement of a Robinson-Patman case that the same antitrust injury be shown as is shown in other antitrust cases. My own sense is, that would be enough to gut the Act of its most serious harmful effects, and that might be the most effective way to get rid of a law that is, I think, an anachronism, and based on the notion that you have to have a level playing field in order to have competition on the merits. Whenever I hear the term "level playing field", I get nervous because that usually means you, my rival, shouldn't be able to take advantage of your comparative advantage over me. It's not, quote, "fair".

Let me talk a bit about price discrimination, because a lot of violations or alleged violations of the antitrust laws, I think, confuse price discrimination with harm to competition. Price discrimination is really a way in which you can compete for individual customers. By giving an individual discount to a customer, it's a way that you can get that customer's business. It's ubiquitous even in places where you think there's lots of competition. In the United States at least—I don't know whether the same is true in England—if you go to a movie theater and you're 65 years or over you get a lower price. Why? You're watching the same movie. You're taking up the same seat. If we count that as price discrimination, are we really worried about market power at the level of movie theaters?

There's very little possibility, without enormous cost, of monitoring price discrimination because there are lots of ways in which you can price discriminate and give secret discounts. You can tie services to the product or give free samples. We know that price discrimination can allow expansion of sales to low value customers. If you don't allow price discrimination, the firm will charge a high price and shut out of the market those consumers not willing to value the service that much. Or, if you do allow price discrimination, those customers can be served.

From economic theory, we know that it's quite ambiguous what the effect on total welfare is, but we do know that the closer you get to perfect price discrimination, total welfare, not necessarily consumer welfare, goes up. A separate question, I don't have time to address it now, is whether you want a consumer surplus standard or a total welfare standard. I thing total welfare makes more sense.

In the United States, we allow a monopolist to charge whatever price he wants. I know in England or in the European Union there can be an exploitive violation, but at least in the United States, a monopolist who has achieved his position legally can charge a monopoly price. That means if you charge a high price, it's okay. It also seems to mean, to me, that you should be allowed to discriminate freely. Therefore, at least under our antitrust laws in the United States, price discrimination, that is pure price discrimination, should not trigger an antitrust violation.

Let me turn to exclusionary conduct. Exclusionary conduct, which is conduct that excludes a rival, may or may not be harmful to competition. Consider tie-ins, and Michael talked about, I think, the ambiguous per se rule of the *Jefferson Parish* case [466 U.S. 2 (1984)]. In fact, I spoke about tie-ins this morning at Oxford University, and my own sense is, at least that in the United States, our laws on tie-in need to be reexamined. We know that one very convincing reason for tie-ins, in addition to efficiency, is to achieve price discrimination. If price discrimination is not an antitrust violation, then use of tie-ins should not trigger any problems. How, then, can tie-ins be harmful? If it's important to distinguish price discrimination from harm to competition, then what's a way to distinguish them?

You should really ask yourself the question: "Is the price to some group of individuals higher than it would be if there was pure price discrimination?" That means if you're the monopolist of some product A, and everybody has to use A in conjunction with B, then as long as you can engage in price discrimination there's no need for you to tie B because you can get all the monopoly rents out of A. If you do tie B because it's a convenient way to engage in price discrimination, it seems to me that should be completely legal.

I want to distinguish that case from the case where there are other consumers of B who have nothing to do with A. A good example, due to Robert Gertner, that I like to use of when that would occur is if there's a resort island. Suppose there's a resort island in which there's a monopolist of a hotel. It also has a restaurant. On this island are native workers who work and live on the island. They work in the hotel and they eat at local restaurants. They don't stay in the hotel. So then what happens? If the hotel ties hotel services to restaurants and makes their guests eat at their restaurant, that could deprive the local restaurants of so much business that they go out of business. That leaves the hotel restaurant as the only one that can serve, not just its guests, whom it could take advantage of anyway, but also the natives. That is harm to competition, or could be harm to competition. Therefore, the right question to ask is: "Does someone's shadow price go up for consumption of the good, and as a result are they harmed relative to what they would have been under price discrimination?" If the answer to that question is: "No", then it seems to me there's no harm to competition. A lot of cases in the United States don't make that distinction.

Let's turn briefly to a recent case, *Leegin*, which the Supreme Court is examining. This is a case in which minimum resale price maintenance is being examined. In fact, the Supreme Court is revisiting whether the per se rule against it should be overturned. As a logical matter, it seems to me that per se can't possibly be correct because we know that resale price maintenance can, under certain circumstances, encourage sales effort that wouldn't otherwise occur. That sales effort can benefit some consumers who will be induced to consume the product and, therefore, it can theoretically expand output. That just means that there are examples where resale price maintenance is being used in a way that may benefit one group. You can decide whether the increased price paid by customers is a net benefit to society when it's compared to the benefit that occurs from expanding output to new consumers.

Leegin is a case involving resale price maintenance of which there have been lots of studies. Earlier Michael talked about prior beliefs. You may start out with prior beliefs, but evidence comes in and you should be updating your priors. So rather than talking about priors, which may be ideology or could be defined as ideology, I'm going to talk about updated priors. Now you can say that's refined ideology, but I would say it's sort of your beliefs that have been improved by looking at the data. That doesn't mean your priors don't matter, but it means if you have enough data, that's going to dominate. And hopefully that's a situation we can eventually get in.

So we have lots of studies of resale price maintenance. Maybe not the greatest studies, but we have lots of them. Here's what some of the evidence shows, and the reason I know this is because I worked on the *Leegin* brief—the amicus brief—that the [U.S.] Department of Justice submitted and it was actually a lot of fun. I held a mini seminar at the Department of Justice where you have this concentration of lawyers and economists who like to talk about antitrust, even when they don't have to. So I reviewed these studies, and here's what the evidence shows, and I thought it was pretty compelling.

First, both internationally and in the United States, there have been times when resale price maintenance has been allowed and when it's not been allowed. We can actually look where it's used and where it's not used. When resale price maintenance is used, it's often used in non-concentrated industries. That immediately tells you something. It means that it must be being used for efficiency reasons, because if it weren't, if it was being used for monopolization purposes, then you wouldn't expect it to be used in these unconcentrated industries.

In general, resale price maintenance leads to increased sales effort. It can lead to higher prices and sometimes significantly higher prices, especially at discount stores. There are few cases that support the economic theory that resale price maintenance by and large is used primarily to facilitate either a dealer cartel or a manufacture cartel. That doesn't mean there are no such cases, but it does mean that if you compare those cases relative to all the other cases, they're a small fraction, under 10 percent or 15 percent. Therefore, resale price maintenance based on this evidence is more popularly viewed as a way to control distribution, which then induced a sales effort, or some other effort, advertising, et cetera, in order to better sell the product. Therefore, I don't think that when you talk about resale price maintenance and you look at the evidence, that the presumption should be that it's per se illegal. Based on this evidence, I would say that you would make the presumption be it's legal unless you could show a harmful effect.

But this does seem to be one of those cases where there is lots of evidence on the practice, and we should let it inform our updated priors.

As a general matter, we do not control how a manufacturer chooses to produce its good. I don't tell General Motors, "you're producing too many red cars, I want them green." Why then, as a general matter, should we tell General Motors how it should distribute its cars? They're really part of the same process of bringing a good to market. If you generally think one is okay, you should think the other is okay.

[...]

FLETCHER: I'm going to tie up because we really should at this stage. It may not be great for legal certainty—that economists don't always agree with each other—but it makes for a good debate, I think. So I hope everyone will join with me to thank our speakers.

EVANS: Thanks Amelia and again thanks to everyone on our panel.

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Competition Law Takes Off in Singapore: An Analysis of Two Recent Decisions

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Competition Law Takes Off in Singapore: An Analysis of Two Recent Decisions

Burton Ong

The first two decisions by the Competition Commission of Singapore, issued in the first quarter of 2007, represent important milestones in the implementation of competition law in Singapore since the enactment of the Competition Act 2004. Both cases involved cooperation agreements between airline operators who had sought negative clearance through the Commission's notification process. This article provides an overview of the legal and policy background behind the new competition regime and, in particular, explains how the new statutory provisions concerned with anticompetitive agreements were applied to the two notified agreements described above. An analysis of these two cases is also conducted to illustrate how the competition regulator has interpreted the relevant competition law principles in the course of its decision-making process.

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I. Introduction

Competition law arrived in Singapore with the enactment of the Competition Act 2004 (hereinafter the "Competition Act" or the "Act"), followed shortly by the establishment of the Competition Commission of Singapore (CCS) on January 1, 2005.[1] Modeled after the Anglo-European competition law regime, the new laws comprise a classic trinity of statutory prohibitions against anticompetitive agreements (as described in Section 34 of the Act and hereinafter the "Section 34 prohibition"),[2] conduct which amounts to an abuse of a dominant position (as described in Section 47),[3] and mergers which result in a substantial lessening of competition within Singapore (as described in Section 54).[4] The prohibitions against multi-party and unilateral anticompetitive behavior came into force on January 1, 2006, while the merger regulation regime took effect on July 1, 2007.

Singapore's competition law framework was introduced, in part, to advance broader government initiatives that strengthen and liberalize the domestic economy, which has been driven by various government-linked enterprises for the past few decades and in the aftermath of the Asian financial crisis at the end of the last century. The other significant contributing factor behind the introduction of these new laws was the signing of a bilateral free trade agreement between Singapore and the United States in 2003, under which Singapore would introduce a general competition law that would "adopt or maintain measures to proscribe anticompetitive business conduct with the objective of promoting economic efficiency and consumer welfare."[5]

Just over a year after the Section 34 prohibition was brought into force, the CCS issued its first two negative clearance decisions in response to notifications from undertakings that had entered into airline alliance agreements.[6] This arti-

1 The Act was passed by the Singapore Parliament on October 19, 2004. *See* Act No. 46 of 2004, at ch. 50B (October 19, 2004) [hereinafter Competition Act 2004], *available at* http://statutes.agc.gov.sg.

2 *Id*. at § 34 [hereinafter Section 34 prohibition].

3 *Id*. at § 47 [hereinafter Section 47 prohibition].

4 *Id*. at § 54.

5 *See* U.S.-Singapore Free Trade Agreement, May 6, 2003, at art. 12.1 (July 31, 2003) (ratified by the United States Congress), *available at* http://www.fta.gov.sg and http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/Section_Index.html. A more detailed overview of the legislative background to the Competition Act 2004 is set out in B. Ong, *The Competition Act 2004: A legislative landmark on Singapore's legal landscape*, SING. J.L.S. 172 (2006).

6 Section 44 of the Act provides a mechanism for parties to agreements that wish to have their agreements examined by the Competition Commission to apply to the CCS for a decision as to whether or not the Section 34 prohibition has been infringed and whether or not the agreement qualifies for any of the statutory exclusions or block exemptions. A decision from the CCS that an agreement does not infringe the Section 34 prohibition enjoys a limited immunity from future penalties under Section 46 of the Act.

cle introduces the legal and policy foundations that underpin Singapore's competition law framework and, against this backdrop, evaluates the first two decisions of the Competition Commission. Section II of this article sets out the regulatory policy that the CCS has declared it will adopt in its administration of the statutory prohibitions found within the Act. Section III sets out the key facts and findings of the CCS in the two decisions it has issued in relation to the Section 34 prohibition. Section IV of this article analyzes these decisions and comments on their implications on the state of the law, before making a few concluding observations in Section V.

II. The Competition Commission of Singapore as a Regulatory Agency

The CCS was incorporated as a statutory body under the Act and established as an organ within Singapore's Ministry of Trade and Industry. The Commission comprises members with legal backgrounds, economists, and businessmen, and is headed by a chief executive appointed from within the civil service.[7] The functions and duties of the CCS are statutorily defined to encompass the following:

> "a) maintain and enhance efficient market conduct and promote overall productivity, innovation, and competitiveness of markets in Singapore;
> b) eliminate or control practices having adverse effect on competition in Singapore;
> c) promote and sustain competition in markets in Singapore;
> d) promote a strong competitive culture and environment throughout the economy in Singapore;
> e) act internationally as the national body representative of Singapore in respect of competition matters; and
> f) advise the Government or other public authority on national needs and policies in respect of competition matters generally."[8]

7 For further details regarding the organizational structure of the CCS and its principal office holders, *see* Competition Act 2004, *supra* note 1, at §§ 3-10.

8 *See id*. at § 6(1). It should be noted that these statutorily-defined functions are further qualified by § 6(2) of the Act, which goes on to state that in performing these functions and in discharging its duties under the Act, the CCS "shall have regard to (a) the differences in the nature of various markets in Singapore; (b) the economic, industrial and commercial needs of Singapore; and (c) maintaining the efficient functioning of the markets in Singapore."

As the national competition authority, the CCS is empowered to perform quasi-legislative, executive, and judicial functions in the administration of the competition law regime. It is responsible for drafting the regulations, guidelines, and other secondary legislation necessary to implement the provisions of the Act. It is authorized to carry out market investigations, acting on complaints from the public or on its own accord, and to make determinations as to whether or not any of the statutory prohibitions against anticompetitive behavior have been infringed.

These roles are shared between the two functional groups established within the CCS. The Policy and Economic Analysis Group, staffed primarily with officers with formal training in economics, is tasked with establishing the requisite policy framework and guidelines in implementing the Act, undertaking economic analysis, and conducting market studies, as well as investigating and evaluating the economic merits of competition cases. The Legal and Enforcement Group, comprised of legally-trained officers, is responsible for undertaking legal analyses, reviewing and preparing all the legal documentation needed in the course of the Commission's work, representing the Commission in appellate and all other legal matters, as well as educating the business community on the competition law regime and liaising with other sectoral regulators and international competition authorities.[9]

Where the CCS has decided that the conduct of an undertaking amounts to an infringement of the Act, its decisions are statutorily enforceable through a range of discretionary remedial powers, including directions requiring undertakings to modify or terminate their infringing agreements or conduct, to enter into legally enforceable agreements as may be specified by the Commission, or to pay a financial penalty of up to 10 percent of an undertaking's annual business turnover for each year of infringement, up to a maximum period of three years.[10] Appeals of the decisions made by the CCS may be made to the Competition Appeal Board and, thereafter, to the Singapore High Court and Court of Appeal in accordance with the provisions of the Act.[11] Individuals who suffer loss or damage as a result of anticompetitive conduct prohibited by the Act enjoy rights of private action only after the CCS has established that one of the statutory prohibitions has been infringed, and may seek judicial relief—such as injunctive relief and damages—from the courts only after all available avenues of appeal have been exhausted.[12]

9 Further details about the role and internal structure of the CCS and its output can be obtained from their website. *See* Competition Commission Singapore, *at*, http://www.ccs.gov.sg (last visited Sep. 6, 2007).

10 *See* Competition Act 2004, *supra* note 1, at § 69.

11 *See id.* at §§ 71-74.

12 *See id.* at § 86.

A. THE COMPETITION AUTHORITY'S REGULATORY POLICY

In the introduction to *The CCS Guidelines 2005*,[13] the CCS describes its role as the administrator of Singapore's competition law regime in the following manner:

> "The mission of the Competition Commission of Singapore (CCS) is to *promote healthy competitive markets that will benefit the Singapore economy*. Healthy competition is good for businesses and consumers alike. It promotes quality, diversity and innovation–characteristics which are highly valued in Singapore's open economy–and leads to economic growth which benefits out entire nation.
>
> The CCS' *approach is based on sound economic principles applied objectively and consistently*. It will investigate and enforce the Competition Act in a consistent and transparent manner while respecting confidentiality."[14] (Emphasis added)

THESE STATEMENTS REFLECT AN UNDERLYING UTILITARIAN PHILOSOPHY OF COMPETITION LAW IN SINGAPORE—THAT IT WILL BE USED AS AN INSTRUMENT TO ENHANCE THE COMPETITIVENESS OF THE MARKETS WHICH COMPRISE THE DOMESTIC ECONOMY.

These statements reflect an underlying utilitarian philosophy of competition law in Singapore—that it will be used as an instrument to enhance the competitiveness of the markets which comprise the domestic economy—and that the CCS intends to employ an economics-based approach towards the interpretation and application of the statutory prohibitions in the Act. Competition law is not concerned with protecting the interests of individual businesses or competitors—its primary goal is to target those forms of private conduct that serve as impediments to an efficient and competitive market-based economy.

13 In 2005, the CSS published three sets of competition guidelines. The first set included Guidelines on the Major Provisions; Section 34 Prohibition; Section 47 Prohibition; and Market Definition. *See* COMPETITION COMMISSION OF SINGAPORE, CSS GUIDELINES (Jul. 29, 2005). The second and third sets included Guidelines on the Powers of Investigation; Enforcement; Notification for Guidance and Decision; Lenient Treatment for Undertakings Coming Forward with Information on Cartels; Transitional Arrangements; and The Appropriate Amount of Penalty. *See* CSS GUIDELINES (version dated Nov. 23, 2005). The Guidelines on Treatment of Intellectual Property Rights was published at the end of the year. *See* CSS GUIDELINES (version dated Dec. 20, 2005). Hereinafter individual CSS guidelines are referenced as they are described here. For the latest version of the guidelines, *see* COMPETITION COMMISSION OF SINGAPORE, THE CCS GUIDELINES (2005), *at* http://www.ccs.gov.sg/Guidelines/index.html (last visited Oct. 4, 2007).

14 These self-declarations are consistent with the "Mission and Value Statement" of the CCS, as reflected on its website. *See* Competition Commission Singapore, Mission and Values Statement (Jan. 24, 2006), *at* http://www.ccs.gov.sg/AboutUs/Mission/index.html (last visited Sep. 7, 2007).

1. Regulatory Priorities and Interagency Cooperation

As a newly created competition regulator with a small head count, the CCS has clearly articulated is discretionary authority in relation to its administrative priorities: "The CCS will set its strategic priorities and consider each case on its merits, and in light of available resources, to see if it warrants an investigation."[15] The Competition Act 2004 envisages the CCS as a general competition authority with an expansive regulatory jurisdiction. Given its limited regulatory capacity and inexperience, it is not surprising that legislators consciously sought to limit the CCS' responsibilities by excluding activities in certain sectors of the economy from the scope of the Act. For example, agreements or conduct involving undertakings in industries already regulated by sectoral competition laws administered by another regulatory authority are excluded from the Sections 34 and 47 prohibitions.[16] In those industry sectors that have specialist industry regulators but no industry-specific competition code, the CCS has declared that it intends to cooperate with these other regulatory authorities on competition related matters:

> "On cross-sectoral competition cases, the CCS will work out with the relevant sectoral regulator on which regulator is best placed to handle the case in accordance with the legal powers given to each regulator. The CCS will work closely with other regulators where necessary to prevent double jeopardy and minimise regulatory burden in dealing with the case."[17]

Such an approach ensures that the competition policy administered by the CCS complements, or at least does not undermine, the regulatory policies developed by other statutory bodies responsible for specific industry sectors.[18] In the two decisions discussed below, involving airline alliance agreements, it is very

15 *See* CCS Guidelines on the Major Provisions, *supra* note 13, at para. 3.6.

16 Other exclusions from the scope of the statutory prohibitions in the Competition Act 2004 can be found in the Third Schedule of the Act, including industry sectors without their own sectoral competition codes, but are subject to their own comprehensive regulatory regime. These include the postal services sector, the supply of piped potable water, wastewater management services, public bus and rail services, and cargo terminal operations.

17 *See* CCS Guidelines on the Major Provisions, *supra* note 13, at para. 3.7.

18 It remains to be seen how effectively the CCS' competition policy will gel with the established policy frameworks devised by industry regulators in other key sectors of the Singapore economy, such as the banking and financial services industry, the legal and medical professions, and the housing and property development industry.

clear that the views of the Civil Aviation Authority of Singapore were given serious consideration by the CCS before it issued a decision.

2. The Guidelines Issued by the CCS

One of the most practical and significant facets of the CCS' regulatory policy lies in the attitude it takes towards the guidelines it issued to clarify the scope of the general statutory provisions found within the Competition Act 2004. Most of the first year of the CCS' existence was spent drafting a set of eleven guidelines that cover the various substantive and procedural aspects of the new competition law.[19]

These guidelines serve as an important adjunct to the primary legislation because they reflect how the CCS intends to interpret and apply the provisions in the Act. This is particularly important where the key statutory prohibitions against anticompetitive conduct are concerned because of the broad and open-textured character of the statutory language that has been adopted in these legislative provisions. The underlying spirit of the CCS Guidelines has been summarized by the CCS in the following manner:

> "Rather than being prescriptive and detailed, the guidelines should outline the conceptual, analytical and procedural framework, within which the CCS will investigate and assess complaints and undertake enforcement. This is also in line with the approach of competition authorities elsewhere. The guidelines can only provide a general indication on how the CCS will administer and enforce the Act; the guidelines are not intended to be individual firm- or sector-specific rules. The application of the guidelines will depend on the facts of each case. The CCS will, however, apply its guidelines in a consistent and coherent manner."[20]

In addition, there is an important qualifying caveat made in the introductory sections of almost all of the guidelines published by the CCS:

19 *See supra* note 13.

20 Competition Commission of Singapore, Guidelines Policy Paper (Jul. 29, 2005), at para. 3c, *available at* http://www.ccs.gov.sg/Guidelines/Guidelines+Published+and+Policy+Paper.htm. The paper was released to accompany the first set of CSS Guidelines on the Section 34 and Section 47 Prohibitions (*see supra* note 13).

> "These guidelines are not a substitute for the Act, the regulations and orders. They may be revised should the need arise. The examples in these guidelines are for illustration. They are not exhaustive, and do not set a limit on the investigation and enforcement activities of the CCS. In applying these guidelines, the facts and circumstances of each case will be considered. Persons in doubt about how they and their commercial activities may be affected by the Act may wish to seek legal advice."[21]

These statements reiterate the fact that the CCS Guidelines do not, strictly speaking, carry the same legal status as the corpus of secondary legislation—regulations and orders—promulgated under the Competition Act 2004. The regulations issued under the Act establish the formal procedural framework within which the CCS is required to operate, while the orders issued under the Act, by the Minister of Trade and Industry, provide detailed guidance on specific aspects of the competition law regime, such as the manner in which financial penalties will be calculated by the CCS or the scope of a block exemption.[22] While the CCS Guidelines may lack the degree of legislative formality or permanence associated with regulations or orders, they are nevertheless important legal instruments that reflect the CCS' regulatory policy and will certainly be relied on by the legal community to provide some degree of guidance to the ambit and application of the statutory prohibitions found within the Act.

Given that the first two decisions of the CCS concerned cases which involved the Section 34 prohibition, the next section of this article will outline the specific regulatory policy the CCS has developed around this particular statutory prohibition against multilateral anticompetitive behavior.

B. THE SECTION 34 PROHIBITION

Section 34(1) of the Competition Act 2004 prohibits, subject to the statutory exclusions found in the Third Schedule of the Act, "agreements between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction or distortion of competition within Singapore are prohibited unless they are exempt" in accordance with the provisions of the Act. Section 34(3) goes on to declare that any provision of any agreement or any decision which falls within the scope of the Section 34 prohibition is automatically void on or after January 1, 2006.

21 *See, e.g.*, CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 1.4.

22 *See, e.g.*, the Competition (Financial Penalties) Order 2007 (S372/2007) and the Competition (Block Exemption for Liner Shipping Agreements) Order 2006 (S420/2006).

A list of examples of conduct which may have the object or effect of preventing, restricting, or distorting competition within Singapore is set out in Section 34(2)—these are agreements, decisions, or concerted practices which:

> "(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; or
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

Where an agreement is made outside Singapore, or if it involves parties who are based outside of Singapore, the agreement is viewed by the CCS as subject to the statutory prohibition as long as the object or effect of the agreement is the prevention, restriction, or distortion of competition within Singapore.[23] The CCS has also taken the view that the Section 34 prohibition only applies to agreements which are separate undertakings, and does not apply to agreements where there is really only one undertaking involved, that is, an agreement between entities that form part of a single economic unit. As such, agreements between a parent company and its subsidiary are not "agreements between undertakings" if the subsidiary "has no real freedom to determine its course of action in the market and, although having a separate legal personality, enjoys no economic independence."[24] The factors the CCS considers relevant to its assessment of whether or not a subsidiary is independent from its parent or if it forms part of the same economic unit, include the extent of the parent's shareholding in the subsidiary, whether or not the parent has control of the subsidiary's board

23 *See* CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 2.2.

24 *See id.* at para. 2.7. It is fairly clear that the single economic entity doctrine has been imported by the CCS from the European competition law regime, with the European Court of Justice articulating the doctrine as early as in the 1970's in Béguelin Import v. GL Import Export, 1971 E.C.R. 949 (E.C.J.) and reaffirming it, more recently, in Viho v. Commission, 1996 E.C.R. I-5457 (E.C.J.).

of directors, and whether the subsidiary complies with the directions of the parent on sales and marketing activities and investment matters.[25]

1. The Appreciability Concept

In light of the potentially expansive scope of the Section 34 prohibition against agreements whose object or effect is prevention, restriction, or distortion of competition, it was necessary for the CCS to qualify the ambit of the statutory prohibition by introducing the concept of appreciability into the interpretation of Section 34. This reflects a deliberate policy decision to focus the regulatory agency's attention on addressing instances of multilateral anticompetitive behavior that are likely to have a significant negative impact on the competitive process. Paragraph 2.18 of the CCS Guidelines on the Section 34 Prohibition explains that:

THIS REFLECTS A DELIBERATE POLICY DECISION TO FOCUS THE REGULATORY AGENCY'S ATTENTION ON ADDRESSING INSTANCES OF MULTILATERAL ANTICOMPETITIVE BEHAVIOR THAT ARE LIKELY TO HAVE A SIGNIFICANT NEGATIVE IMPACT ON THE COMPETITIVE PROCESS.

> "Any agreement between undertakings might be said to restrict the freedom of action of the parties. That does not, however, necessarily mean that the agreement is prohibited. The CCS does not adopt such a narrow approach and will assess an agreement in its economic context. An agreement will fall within the scope of the section 34 prohibition if it has as its object or effect the appreciable prevention, restriction or distortion of competition unless it is excluded or exempted."

The appreciability concept appears to have been derived from the de minimis doctrine developed by the European Courts,[26] with the CCS providing additional guidelines that significantly resemble the safe harbor market share thresholds found in the European Commission's *Notice on Agreements of Minor Importance*.[27] Paragraph 2.19 of the CCS Guidelines on the Section 34 Prohibition declares that:

25 *See* CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 2.8, where the CCS is careful to qualify itself by stating that "ultimately, whether or not the entities form a single economic unit will depend on the facts and circumstances of each case."

26 *See, e.g.*, the European Court of Justice's decision in Völk v. Vervaecke, 1969 E.C.R. 295 (E.C.J.), in which it has held that "an agreement falls outside the prohibition in Article [81(1)] where it has only an insignificant effect on the market, taking into account the weak position which the persons concerned have on the market of the product in question."

27 European Commission, Notice on Agreements of Minor Importance, 2001 O.J. (C 368) 13 [hereinafter European Commission Notice].

> "as Singapore is a small and open economy, an agreement will generally have no appreciable adverse effect on competition:
>
> - if the aggregate market share of the parties to the agreement does not exceed 20% on any of the relevant markets affected by the agreement where the agreement is made between competing undertakings (i.e. undertakings which are actual or potential competitors on any of the markets concerned);
> - if the market share of each of the parties to the agreement does not exceed 25% on any of the relevant markets affected by the agreement, where the agreement is made between non-competing undertakings (i.e. undertakings which are neither actual nor potential competitors on any of the markets concerned); [28]
> - in the case of an agreement between undertakings where each undertaking is a small or medium enterprise ("SME"). Agreements between SMEs are rarely capable of distorting competition appreciably within the section 34 prohibition.[29]
>
> Where it may be difficult to classify an agreement as an agreement between competitors or an agreement between non-competitors, the 20% threshold will be applicable."[30]

In addition, the CCS goes on to declare in paragraph 2.20 that "an agreement involving price-fixing, bid-rigging, market-sharing or output limitations will always have an appreciable adverse effect on competition, notwithstanding that the market shares of the parties are below the threshold levels mentioned [above], and even if the parties to such agreements are SMEs." This approach is consistent with the one taken in the European Commission Notice, which denies safe harbor protection for agreements that contain hard-core restrictions on competition.[31]

If the agreement in question does have an appreciable adverse effect on competition in Singapore, then the parties to that agreement will infringe the

28 In contrast, the European Commission Notice sets the market share threshold at 10 percent for agreements between competitors and at 15 percent for agreements between non-competitors. *Id.* at para. 7.

29 A similar provision can be found in the European Commission Notice. In Singapore, SMEs are defined as having fixed assets investment of less than US$15 million if they operate in the manufacturing sector and less than 200 workers if they operate in the services sector. *Id*. at para. 3.

30 In the European Commission Notice, a 10 percent market share threshold is applicable where there are difficulties in classifying the agreement. *Id*.

31 *See id.* at para. 11, which states that the Notice does not apply to horizontal agreements to fix prices, to limit output or sales, or to allocate markets or customers.

Section 34 prohibition unless they satisfy the criteria for any of the exclusions found within the Third Schedule of the Act.

2. The Net-Economic-Benefit Exclusion

The exclusion that was successfully invoked by the parties in the two cases discussed below is the net economic benefit exclusion, modeled closely after Article 81(3) of the EC Treaty:

> "Agreements with net economic benefit
>
> 9. The section 34 prohibition shall not apply to any agreement which contributes to —
>
> (a) improving production or distribution; or
>
> (b) promoting technical or economic progress,
>
> but which does not —
>
> (i) impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or
>
> (ii) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question."[32]

Annex C of the CCS Guidelines on the Section 34 Prohibition sets out the CCS' policy approach towards this exclusion and provides an analytical framework for assessing agreements when deciding if they meet the criteria listed above. The exclusion is viewed by the CCS in essentially three parts.

The first limb of the exclusion requires proof of efficiency gains that will arise from the agreement—parties must show that there are objective benefits created by the agreement and the economic importance of such efficiencies.[33] Many types of efficiencies are covered by the criterion that the agreement "contributes to improving production or distribution; or promoting technical or economic progress," and the CCS does not require parties seeking to rely on this exclusion to draw clear distinctions between the various categories because these categories overlap with each

32 *See* Competition Act 2004, Third Schedule, *supra* note 1, at para. 9.

33 *See* CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 10.3.

other considerably.[34] The CCS Guidelines explain the CCS' position on what parties to an agreement need to show in order to satisfy this first limb:

> "The efficiency claims must therefore be substantiated as follows:
>
> - The claimed efficiencies must be objective in nature;
> - There must normally be a direct causal link between the agreement and the claimed efficiencies;
> - The efficiencies must be of a significant value, enough to outweigh the anti-competitive effects of the agreement.
>
> In evaluating the third factor, the likelihood and magnitude of the claimed efficiencies will need to be verified. The undertakings will have to substantiate each efficiency claimed, by demonstrating how and when each efficiency will be achieved. Unsubstantiated claims cannot be accepted. Further, the greater the increase in market power that is likely to be brought about, the more significant benefits will have to be."[35]

The Guidelines suggest that concrete evidence of efficiency gains have to be established, perhaps even quantified in some way to the satisfaction of the CCS, before they can be taken into consideration for the purposes of applying this statutory exclusion. It also appears reasonably clear that the extent of these efficiencies generated by the agreement will have to be weighed against, and must ultimately offset, the anticompetitive object or effects of the agreement.

The second and third limbs of the exclusion require the satisfaction of two negative criteria—that the agreement "does not impose on the undertakings concerned restrictions which are not indispensable to the attainment" of the efficiencies identified in the first limb of the exclusion, and that it does not "afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question." These two limbs restrict the types of efficiency claims that will qualify under the exclusion—one looks at the extent to which the restraints on competition are necessary in order to attain potential efficiencies, while the other is concerned with the extent of the anticompetitive effects arising from the execution of the agreement.

34 Examples of improvements in production or distribution set out in paragraph 10.6 of the Guidelines include "lower costs from production or delivery runs," "changes in methods of production or distribution," "improvements in product quality," and "increases in the range of products produced." Examples of the promotion of technical or economic progress set out in paragraph 10.7 of the Guidelines include "efficiencies from economies of scale and specialization in research and development with the prospect of an enhanced flow or speed of innovation."

35 *See* CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 10.4.

The indispensability requirement in the second limb has been interpreted by the CCS to involve the application of a two-fold test—both the agreement itself, as well as the individual restrictions contained within it, must be "reasonably necessary to attain these efficiencies."[36] Parties seeking to rely on this exclusion must be prepared to justify the necessity of the agreement in general, as well as the specific restraints on competition resulting from it. The CCS Guidelines on the Section 34 Prohibition set out CCS' approach to this limb of the exclusion:

> "The first consideration is whether more efficiencies are produced with the agreement in place than in its absence. The agreement will not be regarded as indispensable if there are other economically practical and less restrictive means of achieving the efficiencies, or if the parties are capable of achieving the efficiencies on their own.
>
> Where the agreement is deemed necessary to achieve the efficiencies, the second consideration is whether more efficiencies are produced with the individual restriction(s) in place than in their absence. A restriction is indispensable if its absence would eliminate or significantly reduce the efficiencies that flow from the agreement, or make them much less likely to materialise. Restrictions relating to price-fixing, bid-rigging, market sharing and output limitation agreements are unlikely to be considered indispensable.
>
> The assessment of indispensability is made within the actual context in which the agreements operate and must in particular take account of the structure of the market, the economic risks related to the agreements, and the incentives facing the parties. The more uncertain the success of the products covered by the agreements, the more restrictions may be required to ensure that the efficiencies will materialise. Restrictions may also be indispensable in order to align the incentives of the parties and ensure that they concentrate their efforts on the implementation of the agreement."[37]

The third limb of the exclusion requires an assessment of the extent of the reduction in competition arising from the agreement. This entails a comparison of the degree of competition in the market, and the degree of market power possessed by the parties to the agreement prior to the agreement, as compared to the situation that is likely to arise after the agreement has been consummated.[38]

36 *See id.* at para. 10.8.

37 *See id.* at paras. 10.9, 10.10, and 10.11.

38 *See id.* at paras. 10.12 and 10.13. Paragraph 10.12 of the Guideline emphasis that the CCS is primarily concerned with evaluating the extent of the reduction in competition that an agreement may bring about, and that "in a market where competition is relatively weak, this factor may be more important."

III. The First Two Decisions of the Competition Commission of Singapore

The CCS' first two published cases involve negative clearance decisions issued with respect to airline alliance agreements which had been notified to it in 2006. Both of these decisions, which were released in the first quarter of 2007, found that even though the Section 34 prohibition in the Competition Act 2004 had been contravened, the notified agreements nevertheless qualified for the net benefits exclusion in the Third Schedule.[39] The facts, findings, and reasoning used by the CCS in both cases are set out below.

A. *QANTAS AIRWAYS/BRITISH AIRWAYS*[40]

In *Qantas Airways/British Airways*, the parties were airline companies that had entered into a joint venture agreement under which they would jointly operate certain scheduled flights into and out of Singapore for an indefinite duration. The comprehensive agreement provided for enhanced cooperation between the two companies in areas including scheduling, marketing, sales, cargo, pricing, holiday products, distribution and agency arrangements, frequent flyer programs, in-flight products, information technology, and purchasing and associated service activities. The purpose of the agreement was to enable both parties to overcome some of the difficulties each faced in operating their respective long-sector services along the so-called Kangaroo Route—the bundle of routes between Australia and Europe, with a midpoint stopover. Qantas, based in Australia, was at one end of the Kangaroo Route, while British Airways, based in the United Kingdom, was at the other end. Both airlines used Singapore as a mid-point stop for their flights to refuel and change crews. Qantas enjoyed higher passenger loads for flights along the segments of the Kangaroo Route between Australia and Singapore, compared to its flights between Singapore and Europe, while British Airways had the opposite problem. The agreement allowed them to combine and coordinate their respective passenger traffic and feed each other's flights out of Singapore, thereby using Singapore as a mini-hub for their operations along the Kangaroo Route.

An agreement of this nature violated the Section 34 prohibition of the Competition Act 2004 because the parties were competitors operating a number of similar flights into and out of Singapore. Under the agreement, the parties were jointly responsible for the costs of certain flights along the Kangaroo Route and jointly shared in the revenues earned from these flights, regardless of which

39 The decisions are currently only available from the CCS' online Public Register. Competition Commission of Singapore – Notification Decisions – Public Register, *at* http://www.ccs.gov.sg/PublicRegister/Notifications+Decisions+-+Public+Register.htm (last visited Oct. 4, 2007).

40 Qantas Airways/British Airways, Case No. CCS 400/002/06 (notified Apr. 24, 2006, decided Feb. 13, 2007) [hereinafter *Qantas/BA*].

carrier actually operated the service. The agreement involved fixing prices along all routes between Australia and Europe, Australia and Southeast Asia, and Europe and Southeast Asia, and also involved jointly managed capacity and yields along some of these routes. So if both airlines offered flights from Singapore to the same destination, or from the same point of origin to Singapore, and the passenger load from one flight could be absorbed into the other's service, the agreement enabled one of the airlines to eliminate its scheduled flight and divert its passengers to the other airline's service.

The CCS defined the relevant markets as the markets for scheduled air passenger transport, comprising various individual routes along the Kangaroo Route in which both parties operated.[41] These included the Singapore-London, Singapore-Frankfurt, Singapore-Sydney, and Singapore-Melbourne routes. The combined market shares of the parties in these markets averaged around 34 to 38 percent.[42] This exceeded the 20 percent market share threshold for assessing whether an agreement has an appreciable adverse effect on competition[43] and the CCS found that the agreement "may have the appreciable effect of preventing, restricting or distorting competition for the provision of scheduled air passenger transport" on these specified routes.[44]

However, the Section 34 prohibition was excluded from operating against this agreement because the CCS was prepared to find that the agreement satisfied the net economic benefit exception set out in paragraph 9 of the Third Schedule of the Competition Act 2004. The parties argued that their agreement yielded net economic benefits (and should therefore be excluded from the ambit of the Act) because, in the absence of the agreement, they would have relocated their air-hub away from Singapore to another city in the region. There were difficulties in quantifying the efficiency gains because the agreement had been in place for more than a decade (the original agreement started back in 1995) and the counterfactual submitted by the parties was based on "what the Parties would most likely do, rather than what the Parties could potentially do, if the Agreement is

41 Reference was made to the market definitions adopted by the European Commission in other airline cases. *See* KLM/Alitalia, Case No. COMP/JV.19 (Aug. 11, 1999), at para. 52; Air France/Sabena, Case No. COMP/M.157 5 C.M.L.R. M1 (1994), at para, 25; and Lufthansa/SAS, 1996 O.J. (54) 28, 4 C.M.L.R. 845 (1996), at para. 31.

42 More detailed data relating to the relevant market shares submitted by the parties to the CCS can be found in *Qantas/BA*, *supra* note 40, at paras. 42-43.

43 The 20 percent indicative threshold is set out CCS Guidelines on the Section 34 Prohibition, *supra* note 13, at para. 2.19.

44 In relation to the markets for air freight services and the sale of air travel services, the CCS concluded that market shares of the parties to the agreement were found to be too low to result in an appreciable prevention, restriction or distortion of competition in these markets. *See Qantas/BA, supra* note 40, at paras. 88 and 92.

not excluded from the section 34 prohibition."[45] Under this counterfactual involving the withdrawal of air services from Singapore, in the absence of the agreement, the parties said they would reduce their flights to or from Singapore by between 44 and 68 percent or cease operating all of their flights in a particular sector of the Kangaroo Route.[46] With the cooperative agreement in place, however, the parties claimed that they would achieve significant productive efficiencies through cost reductions and service improvements arising from the coordination of their flights as well as efficiencies achieved through the development of joint facilities (such as sales teams, retail shops, customer service facilities, and airport lounges). Cost savings were achieved from the higher passenger load which they would enjoy on all their flights because of the passenger feed between the airlines, as well as from coordinating their flight services so that the different flights along the Kangaroo Route would be allocated to the party that was better placed to operate each particular service.

Other economic benefits arising from the agreement identified by the parties in their submissions to the CCS included the lower airfares offered by the parties (as a result of their cost savings), improved flight schedules which minimized connection times, the addition of extra flights on high-demand routes and on routes which may not have enough demand to support a service, and economic benefits to the Singapore economy from increased tourism and tourism-related employment as a result of the parties using Singapore as an air-hub.

While the CCS accepted, on balance, that the agreement satisfied the net economic benefit exception, it expressed some reservations about the credibility of the counterfactual put forward by the parties that they would shift their hub out of Singapore to another city in the region. This was because, despite requests by the CCS, the parties did not submit any documentary evidence from their respective boards of directors to indicate that they would act this way in the absence of the agreement.[47] The counterfactual also failed to account for the feasibility of shifting their air-hub to a rival airport in light of the capacity limitations of alternative locations arising from the various Air Services Agreements between Australia and the other jurisdictions, the availability of suitable timeslots for flights to and from these countries, passenger travel patterns, and other commercial arrangements.

In deciding if the agreement contributed to "improving production or distribution" or "promoting technical or economic progress" (the key substantive

45 *See id.*, at para. 45.

46 *See id.* at para. 48.

47 In the Commission's opinion: "since the arguments put forward by the Parties on how the Agreement will satisfy the net economic benefit criteria hinge critically on the counterfactual, the Commission will tend to view the arguments with some reservations in the absence of such supporting documentation." *See id.* at para. 69.

requirements of the exception in paragraph 9 of the Third Schedule), the CCS explained that, "[f]or this criterion of the net economic benefit test to be met, it is necessary for any objective benefits resulting from the Agreement to outweigh and compensate for any detriments to competition."[48]

In assessing the various economic benefits identified by the parties as arising from the agreement, the CCS acknowledged that it would improve Singapore's connectivity as an airline hub, but observed that most of these benefits would accrue to passengers from either end of the Kangaroo Route (Europe or Australia) rather than passengers from Singapore. The parties' claims that the agreement resulted in tourism benefits to Singapore was not supported by the CCS because it was probably only one of the many factors that contributed to Singapore's tourism industry. Other significant factors that influenced tourism demand included the relative costs of other destinations and the perceived attractiveness of Singapore as a tourist destination. On the other hand, the CCS agreed with the parties that the agreement would improve the quality of the air passenger transport markets in Singapore "through better scheduling, more flight connections and efficiencies through joint activities such as purchasing and marketing."[49]

Turning to the next limb of the net economic benefit exception, the CCS was satisfied that the agreement did not "impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives."[50] The parties argued that the benefits of the agreement could not be achieved as effectively through less comprehensive code-sharing[51] and interlining agreements.[52] Feedback from third-party airlines indicated that cooperative agreements such as the one submitted by the parties to the CCS for clearance "are likely to be found in varying degrees amongst members of all airline alliances."[53] Without quantifying how the alleged benefits of the agreement exceeded the benefits that could be reaped under these alternative (and less restrictive) arrangements, the CCS concluded that the economic benefits it identified were "dependent on the full integration of the two Parties' networks and services,

48 *See id*. at para. 70.

49 *See id*. at para. 74.

50 *See id*. at para. 78.

51 A code-share agreement is one where one airline, the marketing carrier, is able to sell seats on a flight operated by another airline carrier using the marketing carrier's designator code. This allows the marketing carrier to increase the number of flights it has to offer to its customers and extend its number of destinations through a virtual network of carriers without having to operate additional flights.

52 An interlining agreement is a transaction between carriers where passengers, baggage, and freight are transferred from one carrier to another using only one ticket or check-in procedure from departure point to destination. It does not require fully integrated cooperation between the parties who form such alliances.

53 *See Qantas/BA*, *supra* note 40, at para. 78.

including joint revenue sharing, scheduling and fare setting, and that the restrictions in the Agreement are necessary to attain those benefits."[54]

Finally, the CCS was satisfied that the agreement did not "afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question."[55] This was because there were "numerous carriers flying between Singapore and major Australian cities, with the exception of Darwin" and Singapore Airlines enjoyed "substantial market shares on all these routes." The Singapore-Darwin route was also serviced by Tiger Airways (a subsidiary of Singapore Airlines) which had recently entered the market in late 2005 and had "since captured a significant market share and was likely to continue to be a strong competitor to the Parties."[56] The CCS took the view that the presence of significant market players on all the routes served by the parties to and from Singapore was likely to continue to impose competitive pressure on the parties. For example, the figures provided by the parties indicated that Singapore Airlines had 57 to 59 percent of the Singapore-Sydney market and 50 to 51 percent of the Singapore-London market, while the parties had combined market shares of 34 to 36 percent of the Singapore-Sydney market and 35 to 38 percent of the Singapore-London market.

The CCS decision also referred to the views of the Civil Aviation Authority of Singapore and the Singapore Ministry of Transport which stated that, "in line with the international trend towards air services liberalization," they were "supportive of allowing airlines to enter into cooperative marketing arrangements" and had "no objection in-principle to the Agreement."[57]

B. *QANTAS AIRWAYS/ORANGESTAR INVESTMENT HOLDINGS*[58]

In *Qantas Airways/Orangestar Investment Holdings*, the parties to the cooperative agreement were related companies in the airline industry. Qantas operated its airline business out of Australia, while Orangestar was the holding company for two value-based, intra-Asia carriers (Jetstar Asia and Valuair) based in Singapore. Orangestar was a subsidiary company of Qantas, which held 44.5 percent of the former's shareholdings through a wholly-owned intermediary company. The remainder of Orangestar's equity was held by Singaporean entities. The notified agreement provided for the coordination of the parties' airline opera-

54 *See id*.

55 *See id.* at para. 79.

56 *See id.* at para. 79.

57 *See id*. at para. 82.

58 Qantas Airways/Orangestar Investment Holdings, Case No. CCS 400/003/06 (notified Apr. 25, 2006, decided Mar. 5, 2007) [hereinafter *Qantas/Orangestar*].

tions and activities for an indefinite duration. The scope of the comprehensive agreement extended to the parties' network and scheduling decisions, sales and marketing initiatives, holiday products and joint promotions, pricing and inventory decisions, rebate and incentive programs for their product distribution channels, frequent flyer and loyalty programs, support services, and personnel sharing and training arrangements. The parties claimed that the close cooperation among Qantas and its related airlines envisaged under the agreement was necessary "if Qantas wishes to respond competitively to the challenges of the global aviation industry."[59] The agreement between the parties was conditional on authorization from both the Australian Competition and Consumer Commission (ACCC) (which unconditionally authorized the agreement for a period of five years as of September 13, 2006) and a determination from the CCS that the agreement did not infringe the Competition Act 2004.[60]

The parties submitted that their agreement did not fall within the scope of the Section 34 prohibition against anticompetitive agreements because the statutory provision was directed at agreements between undertakings and, since this was an agreement between a parent and a subsidiary company, the parties ought to be treated as a single economic entity.[61] In assessing the single economic entity argument, the CCS noted that Orangestar's shareholders' agreement gave Qantas the power to appoint four out of the nine members of the board of directors, while three directors were appointed by another shareholder. The shareholders' agreement required material decisions of the board to be passed by a stipulated percentage of the board members, resulting in both Qantas and this other shareholder wielding blocking rights over material board decisions. After evaluating the arguments submitted by the parties, which included case authorities and legal principles drawn from U.S. antitrust and European competition law jurisprudence, the CCS concluded that that the parties did not form a single economic undertaking.

59 *See id.* at para. 12.

60 It was observed that "the ACCC's authorization is based on its assessment that the Agreement is likely to result in a benefit to the Australian public, and that this benefit would outweigh the detriment to the public constituted by any lessening of competition that is likely to result from the Agreement in markets in Australia." *See id*. at para. 14.

61 Paragraph 2.7 of the CCS Guidelines on the Section 34 Prohibition explains that the prohibition "does not apply to agreements where there is only one undertaking, that is between entities which form a single economic unit. In particular, an agreement between a parent and its subsidiary . . . will not be agreements between undertakings if the subsidiary has no real freedom to determine its course of action in the market and, although having a separate legal personality, enjoys no economic independence." Paragraph 2.8 identifies some of the relevant factors which have to be taken into consideration when assessing if a subsidiary forms part of the same economic unit as its parent. These factors include the size of the parent's shareholding in the subsidiary, the extent of the parent's control over the board of directors of the subsidiary and whether the subsidiary "complies with the directions of the parent on sales and marketing activities and investment matters."

In arguing that they should be considered a single economic entity, the parties relied on the unity of interest test developed by the U.S. Supreme Court in *Copperweld*[62] (in which the Court held that a parent company was incapable of conspiring with its wholly-owned subsidiary in contravention of Section 1 of the Sherman Act[63]), as well as the decisive-influence test used by the European Court of Justice in its decisions concerning Articles 81 and 82 of the EC Treaty.[64] Cases from both jurisdictions in which these tests were applied were considered by the CCS, which, ultimately, took the view that neither test could be applied to support the proposition that the parties ought to be viewed as a single economic entity.

The parties' argument that there was a unity of interest between them was rejected because Qantas, the parent company, held only a minority share (44.5 percent) in Orangestar,[65] with the "majority shareholdings within Orangestar . . . owned by Singaporean interests and not Qantas."[66] The CCS did not accept the parties' claim that there was "no prospect of competition between them" because Orangestar's Shareholders' Agreement contemplated "that the interests of Qantas and Orangestar may diverge and the potential for competition between Qantas and Orangestar exists."[67] A conscious decision was also made by the CCS not to state what shareholding thresholds had to be crossed in order to establish the requisite unity of interest. Neither was the CCS prepared to rule on whether the extensions to the unity of interest reasoning developed by the U.S. courts in cases involving other commercial relationships were applicable to the Singapore

62 In *Copperweld,* the U.S. Supreme Court held that a wholly-owned subsidiary had complete unity of interest with its parent company, such that any agreement between them did not constitute a joining of previously-disparate economic resources. Copperweld Corp v. Independence Tube Corp., 467 U.S. 752 (1984) [hereinafter *Copperweld*].

63 U.S. Sherman Act, 15 U.S.C. at § 1 (2000 and supp. IV 2005).

64 Viho Europe BV v. Commission, 1997 E.C.R. 163 (E.C.J.).

65 Even though the U.S. Supreme Court in *Copperweld* had been careful to limit its application of the "unity of interest" analysis to relationships between parent companies and their wholly-owned subsidiaries (see *Copperweld*, *supra* note 62, at p. 767), subsequent decisions by the U.S. courts have extended the doctrine to cases involving majority-owned subsidiary companies (such in as Novatel Communications v. Cellular Telephone Supply Inc, 1986-2 Trade Cas. (CCH) ¶ 67,412 (N.D. Ga. Dec. 23, 1986). The parties could not provide any clear precedents from the U.S. courts to support their contention that a parent company with less than a majority shareholding in a subsidiary company could invoke this doctrine. The cases cited by the parties (U.S. v. Citizens & Southern National Bank, 422 U.S. 86 (1975); City of Mt. Pleasant v. Associated Electricity Cooperative Inc, 838 F.2d 268 (8th Cir. 1988); Jack Russell Terrier Network of Northern California v. American Kennel Club, 407 F.3d 1027 (9th Cir. 2005); Williams v. I.B. Fisher Nevada, 999 F.2d 445 (9th Cir. 1993)) to support their arguments that such an extension could be made were easy distinguished by the CCS on their respective factual matrices.

66 *See Qantas/Orangestar*, *supra* note 58, at para. 36.

67 *See id.* at para. 41.

context.[68] Furthermore, the mere fact that Qantas had extended significant financial and operational support to Orangestar was not enough to support their unity of interest argument.[69] The CCS observed that the "financial and operational support extended by Qantas to Orangestar appears to be conditional upon the Parties being allowed to coordinate prices and output" through the cooperation agreement between them.[70] In other words, without this agreement, there would no longer be any incentive for Qantas to provide such financial or operational support to Orangestar. Any unity of interest between the parties arose only because of the cooperative agreement contemplated between them. The interests of the parties would not necessarily have been aligned in the absence of the cooperative agreement.[71]

Qantas' other argument for why the two companies should be considered a single economic entity rested on its assertion that it wielded decisive influence over Orangestar. This decisive influence allegedly arose from Qantas' ability to control Orangestar through its blocking rights over material Orangestar decisions. The CCS considered the line of European cases in which one undertaking was treated as part of a single economic entity with another undertaking in which the former exercised sufficient control over the latter, such that the latter did not enjoy any real autonomy in determining its course of action on the market.[72] Noting that the European cases provided no clear precedent that the requisite

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68 *See id.* at para. 43. These relationships include arrangements between members of a cooperative (*City of Mt. Pleasant*), between club and affiliate (*Jack Russell Terrier Network of Northern California*), and between franchisor and franchisee (*Williams*). For cases in parentheses, *see supra* note 65.

69 *See Qantas/Orangestar*, *supra* note 58, at paras. 44-45. Examples of such support given by the parties included the human resources deployed from Qantas to assist in setting up Jetstar Asia, one of Orangestar's airlines, prior to its merger with Valuair, assistance from Qantas in various commercial transactions such as the execution of fuel hedges and negotiating insurance premiums, overall strategic planning between Qantas and Orangestar's airlines, and Qantas' equity funding to Jetstar Asia and Orangestar.

70 The circularity of Qantas' arguments were criticized by the CCS as:

> an attempt by the Parties to lift themselves up by the bootstraps, and cannot be a valid ground for sanctioning the Agreement. Otherwise, parties may enter into other forms of anti-competitive agreements and then claim that their activities should be excluded under the single economic entity doctrine on the ground that the agreements have created unity of interest amongst themselves.

See id. at para. 49.

71 In their correspondence with the CCS, the parties contradicted their "unity of interest" arguments by stating that "without the ability to discuss and agree prices and inventory," under their co-operative agreement, they "would have the incentive and ability to act to further their own interests at the expense of the joint operations," thereby preventing themselves from optimising the utilisation of their aircraft across their combined networks. *See id*. at para. 46.

72 These cases included Viho Europe BV v. Commission, 1997 E.C.R. 163 (E.C.J.), Istituto Chemioterapico SpA & Commercial Solvents Corp v. Commission, 1974 E.C.R. 223 (E.C.J.), and J R Geigy v. Commission, 1972 E.C.R. 787 (E.C.J.).

degree of control or decisive influence could be established in a situation where the parent company had less than a majority shareholding in the subsidiary, the CCS took the view that Qantas' control over Orangestar was insufficient for them to establish themselves as a single economic undertaking.

The CCS also rejected the parties' alternative arguments that, even if Qantas lacked complete control over Orangestar, it had joint control over the subsidiary together with the other Singaporean shareholders, which was enough for the parent and subsidiary companies to be considered a single economic entity. The parties had relied on a merger decision of the European Commission involving the acquisition of joint control over an undertaking and a finding that a position of dominance would arise because the entities involved were linked and viewed by the regulator as a single economic entity.[73] The CCS pointed out that even if a joint venture was treated as a single entity with each of its shareholders, any separate anticompetitive agreements between the parties to the joint venture still had to be evaluated independently by the competition regulator and were not automatically excluded under the single economic entity doctrine. In rejecting the parties' attempt at directly importing the single economic entity concept from the merger context into the process for evaluating agreements under the Section 34 prohibition the CCS emphasized that, "there is a difference between viewing a JV and its shareholder as a single economic entity for the purpose of analysing the competitive effects of a merger/acquisition, and viewing them as a single economic entity for the purpose of excluding agreements between them from the scope of the section 34 prohibition."[74]

Any joint control which Qantas had over Orangestar—control that it had to share with Orangestar's other shareholders—was insufficient to give Qantas the requisite degree of control that would allow it to invoke the single economic entity doctrine on the facts of this case. Drawing an analogy with another European Commission decision involving an agreement between a joint venture company and one of its parents, the CCS could not accept that there was adequate control in this case because:

1. Qantas' share of stock did not exceed the 50 percent mark;
2. Qantas could only name less than half of the board of directors at Orangestar; and
3. Qantas had to share blocking rights over material decisions with another shareholder in Orangestar.

73 The single economic entity doctrine was invoked in the European merger clearance context in Grupo Vilar Mir/EnBw, 2004 O.J. (L 48) where members of the corporate group to which the merging parties belonged were taken to form a single economic entity for the purposes of determining the impact of the merger on competition.

74 *See Qantas/Orangestar*, *supra* note 58, at para. 60, which also discusses the European Commission's joint-venture decision *in* Thomson/Deutsche Aerospace AG, Case No. IV/M.527 (1994).

As such, given the CCS' view that neither the American nor the European competition law principles relied on by the parties could support the position that Qantas and Orangestar formed a single economic entity, the cooperative agreement between the parties was an agreement between undertakings and therefore subject to the Section 34 prohibition.

In seeking a decision from the CCS regarding the legality of their agreement, the parties recognized that the degree of coordination envisaged under the agreement would require them to engage in acts of price-fixing, market allocation, joint purchasing, joint selling, and exchanging price and non-price information between themselves. Given the nature and purpose of the agreement, Qantas and Orangestar wanted to be able to allocate flight services to and from Singapore between themselves to avoid competing directly with each other on the same or overlapping routes. In its decision, the CCS focused its assessment on the effects that the agreement was likely to have on the leisure passenger services market on the Singapore–Australia and Singapore–Asia routes where both airlines had the rights to operate.[75] The CCS observed that, "with regard to the current state of competition," the only overlapping route served by both parties was between Singapore and Denpasar (Bali, Indonesia) and their combined market share was only 16 percent, as opposed to Singapore Airlines, which enjoyed 73 percent of the market share on that route.[76]

This led the CCS to conclude that the agreement was unlikely to adversely affect any actual competition between the parties. However, when they considered the loss of potential competition between the parties, given the increasing popularity of Asian destinations and the possibility of competition that may exist in the absence of the agreement (if, for example, Qantas were to utilize its fifth freedom rights to operate on certain routes between Singapore and other Asian countries), the CCS took the view that "the Agreement may reduce potential competition between the Parties, but the extent of the loss in competition is indeterminable at this point in time."[77] While the CCS could only reach a tentative conclusion on the potential adverse effects of the agreement on competition, it was nevertheless prepared to evaluate the parties' arguments that the

75 *See id.* at para. 93. The CCS also considered the potential effects of the agreement on the markets for air freight transport and the sale of air travel services but, because of the small market shares involved, reached the conclusion that there would not be an appreciable adverse impact on competition in these markets.

76 *See id.* at para. 96.

77 *See id*. at para. 98.

agreement produced net economic benefits that would outweigh the agreement's anticompetitive effects.[78]

The parties pointed to a long list of benefits that they claimed would flow from the cooperation between them under the agreement. These included the addition of new routes and more frequent flights, a boost to Singapore's tourism industry from the increase in the number of travelers, the sharing of expertise between Qantas and Orangestar's airlines, improvements in Singapore's air connectivity as a low-cost regional airline hub, and cost savings for the parties' airlines through greater economies of scale at various operational levels. In concluding that the agreement would yield objective economic benefits in spite of its anticompetitive character, the CCS did not give equal weight to all these alleged benefits. The claimed benefit of new routes and increased flight frequencies was met with some reservation because they would "only become apparent when the demand for these services actualise."[79] The CCS also took the view that any benefits to tourism could not be attributed entirely to the agreement between the parties because of the "wide range of factors which influence tourism demand in Singapore," and was not convinced that Qantas' sharing of its expertise with its subsidiary would not materialize without the agreement, given that it was already providing significant operational and management support to Orangestar.[80]

On the other hand, the CCS agreed that there would be net economic benefits from the agreement because of the improvements in Singapore's air connectivity, which was "likely to in turn increase employment and demand for services related to the aviation industry in Singapore," and because the agreement would "bring about a number of improvements and cost savings in the Parties' operations."[81] The CCS explained that:

> "Specifically, the Agreement will bring benefits such as the improvement of connection across their networks, better scheduling, wider scope for inventory control and higher utilisation though higher load factor. Cost savings

78 It was observed that "the Commission . . . does not rule out the possibility that the Agreement may have an appreciable adverse effect on competition in the future. It will next proceed to assess if the economic benefit arising from the Agreement is likely to outweigh its anti-competitive effects." *See id.* at para. 99.

79 *See id.* at para. 100.

80 *See id.* at paras. 102-103.

81 *See id.* at paras. 101 and 104.

> are likely to arise from economies of scale and sharing of facilities and staff. These will in turn benefit consumers in Singapore."[82]

Furthermore, in reaching its conclusion that the cooperative agreement should qualify for the net economic benefit exception to the Section 34 prohibition, the CCS accepted that the agreement did not impose restrictions that are not indispensable to the attainment of these economic benefits. While the CCS recognized that interline and codeshare agreements could have been used by the parties to yield benefits similar to those offered by the cooperative agreement, the parties alleged that such agreements would not have enabled them to coordinate their scheduling for better connection times, plan their frequencies to maximize route performance, or control their inventory or schedules. The CCS took the view that:

> "[T]o the extent that the benefits of the Agreement will extend beyond those which may be achieved through pure interlining and bilateral agreements, further co-operation akin to that embodied in the Agreement must be required. The benefits outlined by the Parties are dependent on the close co-ordination of the Parties' networks and services and the restrictions in the Agreement are necessary to attain those benefits. Such benefits are not likely to be achieved via less restrictive forms of co-operation."[83]

This assessment of the cooperative agreement between the parties was premised on the CCS' recognition that "the purpose of the Agreement is to provide the Parties with the flexibility to co-ordinate their behaviour in any way possible, in line with the business model that they have adopted, viz. for Orangestar to operate as part of Qantas' flying businesses"—with this commercial context in mind, the CCS was prepared to accept that the agreement was, "in its entirety, indispensable to attaining the benefits claimed and that it [was] not necessary for each of the restrictions in the Agreement to be assessed individually."[84]

Finally, the CCS was satisfied that the net economic benefit exception to the Section 34 prohibition was applicable in this case because it was not likely to

82 *See id.* at para. 104.

83 *See id.* at para. 107.

84 *See id.* at para. 108.

lead to the elimination of competition in a substantial part of the market. Two key factors were identified by the CCS to support its analysis. First, that there were low barriers to entry on the Singapore-Australia routes and Singapore-Asia routes (with the imminent implementation of an open skies framework within the ASEAN region). Secondly, "in view of the competitive presence of other airlines," the CCS considered that the agreement "was not likely to lead to the elimination of competition in a substantial part of the Singapore-Australia and Singapore-Asia markets."[85] No market share figures were given in the CCS decision to support these conclusions.

While the CCS concluded that the Qantas/Orangestar agreement brought about net economic benefits to Singapore, and was therefore excluded from the Section 34 prohibition, it nevertheless expressed a few specific reservations regarding the finality or accuracy of its decision:

> "The Commission recognises that the global aviation market is volatile and dynamic. The Commission also notes that the Agreement has yet to be fully implemented and the effects that the Agreement may have on competition in Singapore may not be actualised in the way which the Parties anticipate. . . . The Commission recognises that its detriment analysis is heavily influenced by its assessment that there is likely to be potential competition on the possible overlapping routes on which the parties may operate. If this assessment is not borne out, the Commission may also initiate a review of the decision based on a material change of circumstances."[86]

IV. Analyzing the Airline Alliance Agreement Cases

Given the structural complexities of the airline industry and its strategic importance to the country's aspirations of serving as a regional and international air hub, these were not easy first cases for the CCS to decide. A number of the issues arising from the application of the Section 34 prohibition and the net economic benefits exclusion turned on findings of fact by the CCS rather than issues of law or legal reasoning. There were, however, a few significant aspects of both decisions that are worth highlighting.

85 *See id.* at para. 112.

86 *See id*. at para. 132.

First, in determining whether or not these airline alliance agreements violated the Section 34 prohibition, the CCS went through the motions of defining the relevant markets and analyzing market shares to reach their conclusions that both agreements would have an appreciable adverse effect on competition in Singapore—a loss of actual competition in *Qantas Airways/British Airways* and a loss of potential competition in *Qantas Airways/Orangestar Investment Holdings*. While the market definition process demonstrates the CCS' commitment to sound economic analysis, it is curious why this was even necessary in these two cases given that there were hard-core restrictions on competition found within these notified agreements. Both cases involved agreements containing price-fixing, output-limiting, and market-sharing arrangements that one would expect to automatically infringe the Section 34 prohibition—especially in light of the policy statements found in paragraph 2.20 of the CCS Guidelines on the Section 34 Prohibition.[87]

Second, the CCS' decision in *Qantas Airways/Orangestar Investment Holdings* demonstrates its willingness to consider competition law cases from both the United States and Europe in its analysis of the single economic entity doctrine that the parties raised as an argument for the non-applicability of the Section 34 prohibition. In rejecting the parties' proposition that they should be treated as single economic entity for the purposes of the statutory prohibition, the CCS very competently distinguished the numerous authorities cited by the parties in support of their assertions. In addition, the CCS' analysis of the single economic entity principle was fairly sophisticated insofar as it was sensitive to the conceptual differences between how the European case law has been applied in the context of anticompetitive agreements which infringe Article 81 of the EC Treaty and in the context of merger regulation.[88]

Third, the CCS' application of the net economic benefits exclusion in these cases is noteworthy for a number of reasons. On the one hand, the CCS was not willing to accept every example asserted by the parties as an economic benefit as efficiency gains which "contribute[d] to improving production or distribution; or promoting technical or economic progress."[89] Economic benefits that were speculative or that were not directly attributable to the operation of the agreement cannot be relied on for the purposes of invoking this statutory exclusion. On the other hand, where it was clear that there would be some economic efficiencies created by the agreement—such as cost savings arising from economies of scale—the CCS appears not to have been concerned with quantifying these eco-

87 *See* CCS Guidelines on the Section 34 Prohibition, *supra* note 13.

88 *See supra* notes 73-74.

89 *See supra* note 32.

nomic efficiencies in any specific detail. Neither is it apparent from these decisions that the CCS attempted to carefully weigh these efficiency gains against the anticompetitive effects of the agreements in question.

Furthermore, it remains unclear from the CCS' decision in *Qantas Airways/Orangestar* whether or not the economic benefits relied on by the parties to justify the invocation of this exclusion have to be transmitted directly to customers or the public at large in Singapore. Even though the CCS accepted that the agreement would reap economic benefits in the form of better airline network connectivity, better scheduling, a wider scope for inventory control, higher load factors, and cost savings from economies of scale and the sharing of airline facilities and staff, it does not follow that these efficiency gains enjoyed by the parties will necessarily "benefit consumers in Singapore" given that the primary beneficiaries of the agreement are the airlines themselves.[90] Moreover, even if consumers stand to benefit indirectly from these airline alliance agreements, are they consumers in Singapore? In *Qantas Airways/British Airways*, the consumers who stand to gain the most from the agreement are not Singapore residents. Those who are most likely to benefit from the better connectivity between the airlines are foreign visitors traveling from either end of the Kangaroo Route, that is, passengers on the flights operating by the parties to the agreement.[91] Similarly, in *Qantas Airways/Orangestar Investment Holdings*, the air passengers who stand to gain the most from the coordination between the airlines are those traveling to and from Australia, where Qantas is based, and are using Singapore as a transit point for their flights to regional destinations.

IT REMAINS UNCLEAR FROM THE CCS' DECISION IN QANTAS AIRWAYS/ORANGESTAR WHETHER OR NOT THE ECONOMIC BENEFITS RELIED ON BY THE PARTIES TO JUSTIFY THE INVOCATION OF THIS EXCLUSION HAVE TO BE TRANSMITTED DIRECTLY TO CUSTOMERS OR THE PUBLIC AT LARGE IN SINGAPORE.

The way in which the indispensability limb of the net economic benefits exclusion was applied by the CCS in these two decisions also raises a number of important issues. In *Qantas Airways/Orangestar Investment Holdings*, both the parties and the CCS acknowledged that alternative agreements with less restrictive provisions—interline and code-share agreements—would have been able to yield similar benefits to those offered by the notified agreement. What was asserted by the parties to, and ultimately accepted by, the CCS was that "to the extent that the benefits of the (notified) Agreement [would] extend beyond those achievable through interline and codeshare agreements, further cooperation

90 *See Qantas/Orangestar*, *supra* note 58.

91 However, it is not too difficult to make an argument that these airline customers, even if they only transit through Singapore, are "customers in Singapore."

would be required"[92] and that "such benefits [were] not likely to be achieved via less restrictive forms of co-operation."[93] The CCS made no attempt to quantify the value of these extra benefits that were alleged to have been only attainable through the notified agreement. A similarly unsatisfactory approach was taken in *Qantas Airways/British Airways* when the CCS addressed the same indispensability issue.[94]

What is not clear from the CCS' decisions is why the parties had not been made to explore intermediate options between traditional interline, code-share agreements and the notified agreement which contained price-fixing and output-limitation provisions. Why couldn't the parties have entered into a less restrictive arrangement without these hard core restrictions, given that they already had strong incentives to cooperate for their mutual benefit? It would not have been unreasonable to expect the parties to have continued to closely coordinate their flight schedules and passenger loads even in the absence of these price-fixing or output-limiting provisions. In *Qantas Airways/British Airways*, the parties had a successful and longstanding partnership of more than ten years that made commercial sense because of their respective geographical advantages. In *Qantas Airways/Orangestar Investment Holdings*, the parties involved were closely related entities whose interests were already aligned to a significant extent, even if it was not enough for them to be treated as a single economic entity, such that it would still have made economic sense for them to continue working together even in the absence of these hard-core restrictions.

Furthermore, in reaching its conclusion in the *Qantas/Orangestar* case that the notified agreement was indispensable to attaining these economic benefits, the CCS decided that it was "not necessary for each of the restrictions in the Agreement to be assessed individually" because of the commercial context in which the notified agreement would operate.[95] This lack of scrutiny was surprising given the hard-core character of some of the restrictions in the agreement, and is somewhat inconsistent with the policy statements found in paragraphs 10.10 and 10.11 of the CCS Guidelines on the Section 34 Prohibition, which provide that "restrictions relating to price-fixing, bid-rigging, market sharing and output limitation agreements are unlikely to be considered indispensable" and

92 It was argued that these alternative agreements "would not allow them to coordinate their scheduling for better connection times and plan their frequencies for better connection times and plan their frequencies together to maximize route performance," and that they would be "unable to control the inventory or schedules of [each others' flights], which would result in Parties having to bear the risk of the operating carrier limiting seat availability of changing flight times, amongst other things." *See Qantas/Orangestar*, *supra* note 58, at para. 106.

93 *See id.* at para. 107.

94 *See id.* at paras. 77-78.

95 *See id.* at para. 108.

that "restrictions may . . . be indispensable in order to align the incentives of the parties."[96] In these two cases, there would already have been preexisting incentives for the parties to cooperate with each other, so it is arguable that not all of the restrictions on competition would have been indispensable for them to further align their incentives to such a degree that would have enabled them to extract the efficiency gains arising from their notified agreements.

V. Conclusion

These airline alliance agreement cases are particularly challenging because of the highly specialized nature of the industry, the international character of some of the relevant issues, and their strategic importance to the national economy. A competition regulator's job is made more difficult by the fact that other players in this industry are unlikely to be too overtly critical of such arrangements in order to avoid attracting unwanted attention to similar arrangements they may have, or wish to have, with each other. These cases also illustrate the importance of a conceptually coherent understanding of the relevant economic benefits that parties to an anticompetitive agreement have to establish before they are entitled to invoke the statutory exclusion. Not all economic benefits to the economy of Singapore are economic benefits that the competition regulator should take into account when determining the legality of an agreement—an issue that featured prominently in these cases.

With these two decisions under its belt, a number of investigations under way, and its first infringement decisions currently in the pipeline, the Competition Commission of Singapore looks set to play a major role in the implementation of the new competition law in the near future. Its first two decisions involving negative clearances for the two airline alliance agreements serve as important milestones in the development of competition law in Singapore, providing the competition lawyers with an interesting glimpse into the future of things to come. The decisions rendered by the CCS in *Qantas Airways/British Airways* and *Qantas Airways/Orangestar Investment Holdings* are highly commendable first efforts from a new regulatory agency and it is hoped that its future decisions will demonstrate increasing analytical rigor and clarity.

96 *See* CCS Guidelines on the Section 34 Prohibition, *supra* notes 13, 36, and 38.

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Competition Policy in Hong Kong: Present Conditions and Future Prospects

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Competition Policy in Hong Kong: Present Conditions and Future Prospects

Mark Williams

Hong Kong has a reputation for being a free and open economy. Historically, the government has maintained that the economic environment is business-friendly, with a small public sector and that competition is the bedrock of sustained growth. The rule of law provides security of property rights and the light-touch regulatory environment allows the invisible hand of competition to work effectively. Unfortunately, this characterization is not an accurate representation of competition conditions in the domestic, non-traded sector of the economy. The government monopoly of the supply of land has facilitated the development of dominant, family-owned conglomerates that extract monopoly rents in many business sectors. Private monopolies in gas and electricity supply, a duopoly in the supermarket sector, tight oligopolies in port services and oil supply, and numerous well-known cartels are prominent features of the local economy. The government now recognizes that the traditional laissez-faire policy needs reconsideration and has announced that a comprehensive competition law will be promulgated. This article outlines the development of competition policy in Hong Kong and examines whether the new ordinance will effectively resolve its entrenched competition problems.

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I. Introduction

For decades Hong Kong has been cited, often uncritically, as the best example of the benefits of a laissez-faire economic policy in ensuring rapid and flexible economic development.[1] This view often reflects an ideological stance and ignores the fact that other small Asian economies—such as Taiwan and Singapore—have also experienced stellar economic performance in the post-war period, but with markedly more government direction, guidance, or state sponsorship. While it is true that Hong Kong has largely maintained a classical mid-19th century liberal political economy model since British colonization in 1841, it is also true that the domestic non-traded sector of the economy is riddled with monopolies, cartels, and anticompetitive, interlocking conglomerate structures.

It is a fallacy to equate the economic freedom found in Hong Kong with the inevitability that such freedom from governmental constraints ensures a vibrantly competitive domestic economy. In fact, the process of competition is impeded by structural factors in the domestic economy and a government monopoly in the supply and regulation of real estate. This article explains these issues and their impact on competition in Hong Kong.

This paper offers a sketch of existing domestic industrial structure and provides examples of anticompetitive behavior, followed by an account of the development of pro-competition policies over the last fifteen years. Existing sectoral competition rules are examined and the probable content of the upcoming general competition law is also discussed. In conclusion, the likely content of the new law is measured against the competition problems that exist in Hong Kong to determine whether the new ordinance will sufficiently address the competition problems in the domestic Hong Kong economy.

II. Political Economy and Domestic Economic Structures[2]

Hong Kong has few legal barriers to entry in the domestic market. There are no import quotas, but duties are levied at the border on petroleum, tobacco, alcohol, and cosmetics. There are no significant barriers to the import or export of capital. The local currency is fully convertible and foreigners may invest in real estate, in the capital markets, or in enterprises as there are no legally restricted business sectors. Consequently, one might expect that foreign capital plays a significant part

1 *See, e.g.*, HERITAGE FOUNDATION, 2007 INDEX OF ECONOMIC FREEDOM (2007), *available at* http://www.heritage.org/index/; and JAMES D. GWARTNEY & ROBERT A. LAWSON, ECONOMIC FREEDOM OF THE WORLD (2007), *available at* http://www.fraserinstitute.ca/economicfreedom/index.asp?snav=ef.

2 For a summary account of Hong Kong's economic history, *see* Catherine R. Schenk, *Economic History of Hong Kong* (February 10, 2005), *at* http://eh.net/encyclopedia/article/schenk.HongKong (last visited Oct. 3, 2007). For an extended discussion, *see* D.R. MEYER, HONG KONG AS A GLOBAL METROPOLIS (2000).

in the capital-intensive domestic economy, but this is not the case. While many multinational corporations locate their regional head offices in Hong Kong and the major international investment banks have a large presence in Hong Kong, foreign corporations play a small role in the domestic economy overall.

Local family-controlled conglomerates, most of which are ultimately real estate developers, dominate most capital-intensive sectors. Gas, electricity, bus and ferry services, the seaport, supermarkets and large retail chains, the major air carrier, telecommunications services, and the residential housing supply are all controlled by local interests. Often the ultimate holding companies have broad cross-sector interests that tend to contract with other group companies, creating high barriers to entry that restrict or prevent competition. The government's land monopoly is the ultimate reason why this web of conglomerates and their interlocking subsidiaries exist.

When Britain took possession of Hong Kong in 1841, the first colonial government was faced with an immediate problem of raising sufficient public revenue to finance its operations. The decision was made that, in order to encourage trade, facilitate commerce, and enhance Hong Kong's position as the premier destination for conducting trade in China, there would be no significant import duties. Thus, the only source of funds was the sale of land rights that the Crown claimed as a result of the conquest and the Treaty of Nanking which ceded Hong Kong Island from China to Great Britain in perpetuity. Subsequently, in 1861, the Treaty of Peking ceded further territory on the Kowloon peninsula on similar terms. The majority of the former Colony's land mass—the New Territories—was ceded on a 99-year lease that ran until 1997. This limited land grant precipitated the diplomatic agreement between the United Kingdom and the People's Republic of China in 1984 that conceded retrocession of the whole colony, as the smaller fraction of the territory held in perpetuity was not viable without integration with the mainland.[3]

The first colonial government began the immediate sale of leasehold land rights, which became its major source of revenue. The system remains largely unchanged today, with government obtaining approximately 30 percent of its present income from the sale of leases, fees for alteration of permitted user, stamp duties, and associated land-based property taxes. The dependence on land-based revenues has brought about the enrich-

The system remains largely unchanged today, with government obtaining approximately 30 percent of its present income from the sale of leases, fees for alteration of permitted user, stamp duties, and associated land-based property taxes. The dependence on land-based revenues has brought about the enrichment of not only the public purse, but also of the major land development companies.

3 Steve Tsang, A Modern History of Hong Kong 1841-1997 (2004).

ment of not only the public purse, but also of the major land development companies. Hong Kong has no public sector debt and has huge fiscal reserves. The real estate developers reaped enormous profits over decades that were largely reinvested in Hong Kong to diversify the parent companies and convert them into conglomerates. Today these conglomerates dominate the non-traded domestic sectors of the economy such as utilities, infrastructure, and retail as well as the real estate market. The Hong Kong banks also fed market demand for mortgage lending to a population that craved the security of tangible assets, especially since many of Hong Kong's residents were economic refugees from the Maoist regime in the mainland between 1949 and 1978.

Consequently, the government and big business became symbiotically dependent on each other. The developers were beholden to the monopoly supplier of land and the government was reliant on the income generated by land sales. Because the government lacked a democratic mandate, direct taxes on the population were kept low, and even today Hong Kong does not have sales taxes. The government, therefore, had to act like any good monopolist by drip-feeding the real estate market to ensure scarcity, maximizing prices and thereby its tax revenues. By utilizing this revenue-raising model, the Hong Kong government has been able to maintain the appearance of being non-interventionist in economic affairs.

A tight land supply policy has had several significant economic effects. Real estate prices for commercial, industrial, and residential uses have been maintained at very high levels for decades. Until 1997, investing in real estate in Hong Kong was usually a one-way bet. Prices rose almost continually, fueled by demand from an increasing population and expanding mainland commerce. The government, developers, banks (who lent on mortgage security to buyers), and investors made money easily. By 1997, real estate prices had reached dizzying levels, but the boom imploded with the onset of the Asian financial crisis and values fell 60 percent by 2003. On several occasions during that time the government attempted to restrict supply and bolster demand. The government attempted to reverse expansionist public housing projects and halted all land sales. As a result of its dependence on land-based revenues, the Hong Kong government experienced current account deficits for four successive years for the first time (with the exception of wartime).

To address the weak domestic economy, mainland policies were adjusted to bolster the Hong Kong economy and to maintain political stability. The central authorities boosted inbound tourism by removing administrative travel restrictions and directed mainland, state-owned companies to undertake initial public offerings in Hong Kong, rather than on foreign stock markets. Beijing also agreed to a new trade pact to facilitate cross-border trade and economic integration. As a result, since 2004, the situation has since reversed and the Hong Kong government now enjoys a record fiscal surplus and real estate values have risen dramatically, though not to the heights of 1997.

Another malign effect of the government's intimate connection with the supply of land is the fact that over 40 percent of Hong Kong's population lives in public-subsidized housing. This surprising statistic arose from a housing crisis caused by the huge influx of poor migrants from the mainland that fled the political and economic turmoil of the 1950's and 1960's. Most of these people were unskilled and unable to afford private sector real estate prices. The government responded by creating an enormous number of public housing units as well as entirely new towns in the New Territories. Today, public housing rents are highly subsidized and access to new units is via a means test and waiting list system. The difference in the cost of rent for a public housing unit and the cost of a mortgage down payment and loan repayments on a private sector apartment is very large. This disparity is a direct result of the restrictive government real estate policy.

The government also prefers to sell relatively large lots of land at auctions. This requires huge, upfront immediate payments that only the largest developers can afford to finance since most developments are of large skyscraper apartment or office complexes, often as high as forty to eighty stories. The cost and lag time to develop such projects requires huge capital reserves. As a result, only a few local companies have the capacity to acquire development sites, ensuring that a tight oligopoly has developed. No foreign players have entered the market as a result.

Tacit collusion between the developers, with respect to land auctions and the sale of completed apartments, has long been suspected. Occasionally, this endemic behavior is revealed as an active bid-rigging ring. In March 2007, at a government land auction, two rival bidders concluded a joint bidding arrangement in full view of the television cameras.[4] Bid-rigging and other cartel practices are perfectly lawful in Hong Kong. The exception is bid-rigging that amounts to a conspiracy to defraud which is potentially a criminal offense under common law. However, it should be noted that in the telecommunications and broadcasting sectors, price-fixing and other cartel behavior are prohibited by sector-specific legislation.[5]

The government's land policy has almost certainly increased the cost of living and doing business in Hong Kong to a significant extent, as the price of land is higher than if the supply was subject to market forces rather than administrative control. These higher costs may, in the long run, affect Hong Kong's international competitiveness. Rents and housing prices are among the highest in the world. Real estate prices are often two-thirds higher than those in adjacent Shenzhen, the mainland special economic zone 25 miles to the north of Hong Kong, though

4 *Move to Ban Land Auction Deals*, The Standard, Mar. 15, 2007, *available at* http://www.thestandard.com.hk/news_detail.asp?pp_cat=11&art_id=40191&sid=12666307&con_type=1&d_str=20070315&sear_year=2007.

5 *See* Telecommunications Ordinance, c. 106 (2007) and Broadcasting Ordinance, c. 562 (2007), *available at* http://www.legislation.gov.hk/eng/home.htm.

this margin has decreased in recent years as a result of the booming mainland real estate market. The cross-boundary differential in real estate prices illustrates the effects of the restrictive land supply policies of the Hong Kong government.

Hong Kong is primarily a service-based economy with over 90 percent of its gross domestic product arising from the services sector. Financial services, logistics, and tourism are the mainstays of the local economy. Manufacturing has largely migrated to mainland sites due to much lower land and labor costs though finance, design, and logistics are still usually handled in Hong Kong. The economy is increasingly dependent on the greater Pearl River delta and China's economy generally. Most of the trade at the port is trans-shipment of goods to and from the mainland. The airport cargo and passenger sectors are increasingly becoming hubs for China-related markets. The vast majority of tourist arrivals are from China. The banking, financial services, legal, and accounting sectors are also heavily dependent on the mainland economy.

Given the ever-increasing dependence of Hong Kong on the mainland, the issue of whether the domestic, non-traded sector of the Hong Kong economy is flexible and nimble enough to withstand future economic shocks is an increasing concern. Hong Kong has not developed significant research-intensive, high-technology industries such as electronics, pharmaceuticals, or biomedicine. Health care and educational services are comparatively inward-looking. They have not developed their capacity fully to become preeminent centers of regional excellence that could attract large numbers of foreign patients or students with a more diversified income stream or that could serve as an incubator of highly skilled human capital. Hong Kong's population skill profile has become a matter of considerable concern to the government as part of the ongoing efforts to maintain a competitive edge over increasingly confident regional rivals such as Shanghai and Singapore.

Hong Kong is a small economy by most standards. With a population of approximately seven million and a geographical extent of just over 1,000 square kilometers, high concentration ratios might be considered inevitable given the need to obtain economies of scale. While this is true, the unique characteristic of the Hong Kong economy is the tight, cross-sector ownership of the domestic conglomerates. In some ways, this is similar to the chaebol phenomenon found in South Korea, and to a somewhat lesser extent in other East Asian economies, but the scale of the problem in Hong Kong is exceptional.

Given the lack of overt government barriers to entry in most markets, one might expect to see either a very competitive domestic economy or a highly concentrated sluggish one dominated by entrenched monopolies and cartels formed as a result of unfettered consolidation. In reality there is a dichotomy between small-scale business that is largely competitive and large-scale business that is highly concentrated and often lacks robust competition. This situation has arisen because historically the government's non-interventionist policies have combined low external trade barriers and a laissez-faire domestic economic policy with minimal intervention in economic affairs, including no industrial policy imperatives, and government provides only basic public services (e.g., security, water supply, rail services, health care, educational services and social housing), financed by a low direct tax system. This orthodoxy has dogmatically asserted that a competition law is interventionist and not to be tolerated. The mindset of successive Hong Kong governments has been perfectly aligned with that of the local tycoons. The renowned business friendliness of the Hong Kong authorities has become an effective abdication of responsibility for the wider public interest in maintaining competitive domestic markets.[6]

This ideological position has facilitated the creation of the existing structure of the domestic non-traded sector—high levels of concentration, substantial cross-sector ownership, and family control. Entry into many markets is difficult or impossible for a number of reasons, including the dominance of incumbents and the inability of new entrants to acquire sufficient scale of operations due to site scarcity or relatively small volumes of local demand. These structural impediments are compounded by tacit "no poaching" arrangements between incumbents or by overt anticompetitive practices to discourage the entry of rivals. Invisible privately erected barriers to market entry are common.

The cross-ownership and the small number of players in capital-intensive sectors are the roots of the competition problems found in the Hong Kong economy. To address the structural impediments effectively, a competition law must contain powers to review mergers to prevent further concentrations that could create or buttress positions of market power. The new law also needs the ability to dismantle existing economic structures that are shown to prevent competition from taking place. As this paper will discuss later, these are exactly the powers that the Hong Kong government has been reluctant to grant to the new competition authority. Lobbying by vested economic interests with political leverage may well have a powerful effect on the competition regime that emerges from the ongoing policy debate.

III. Anticompetitive Behavior

As other jurisdictions have witnessed, prior to the implementation of new competition laws, businesses take action to preserve their self-interest. They strengthen positions of market power through takeovers and mergers, creating higher concentration ratios. When a merger is not possible, then collaboration between competitors to reduce competitive intensity is often a successful substitute to protect profit margins, particularly if market entry is difficult or if the number of firms involved in the relevant market is not too great. This is especially true in oligopolistic markets in which mutual surveillance by conspirators

6 For a discussion of these issues, *see* Leo F. Goodstadt, Uneasy Partners: The Conflict Between Public Interest and Private Profit in Hong Kong (2005); and Tony Latter, Hands On, Hands Off, The Nature and Process of Economic Policy In Hong Kong (2007).

to ensure against cheating is more easily accomplished, and in small, isolated economies in which all of the business actors are readily identifiable and may participate in trade associations that facilitate collaboration. Even if active collusion is not practiced, smallness facilitates price leadership and tacit collusion.

Structural conditions, as well as the cultural homogeneity of the Hong Kong business community, facilitate the use of both exclusionary and exploitative tactics by dominant incumbents with market power. Structure and culture also promote restrictive business practices between nominal competitors, so that cartels proliferate to fix prices, share markets, or engage in bid-rigging. The absence of any legal prohibitions against such activities, with the exception of fraudulent criminal conspiracy cases and sectoral prohibitions in the telecommunications and broadcasting industries, means that not only is such behavior tolerated, but that such contracts may be legally enforceable under common law.[7]

CHALLENGERS TO DOMINANT UNDERTAKINGS OR CARTELS ARE DISSUADED FROM COMPLAINING BY THE UNRESTRAINED ABILITY OF THE INCUMBENTS TO RETALIATE COMMERCIALLY. THE SHEER DIFFICULTY, EVEN IMPOSSIBILITY, OF GAINING A FOOTHOLD IN SOME MARKETS OFTEN MEANS THAT NEW ENTRANTS ARE DETERRED FROM ENTRY, OR IF THEY DO ATTEMPT TO ENTER, IT IS OFTEN AS A JOINT VENTURE WITH AN INCUMBENT WHO KNOWS THE RULES.

Several examples, discussed in the sections that follow, demonstrate the numerous types of anticompetitive behavior that exist in Hong Kong. However, the true extent of the problem is largely hidden from view. Businesses do not advertise such practices as they are generally not defensible to skeptical consumers. Challengers to dominant undertakings or cartels are dissuaded from complaining by the unrestrained ability of the incumbents to retaliate commercially. The sheer difficulty, even impossibility, of gaining a foothold in some markets often means that new entrants are deterred from entry, or if they do attempt to enter, it is often as a joint venture with an incumbent who knows the rules. The fact that such commercial behavior is regarded as within the socially and legally permissible norms reinforces the contention that complaints to the authorities are futile in the absence of any legal prohibition. This may well explain the abject failure of the government's competition watchdog, the Competition Policy Advisory Group (COMPAG), to foster a more dynamic domestic market.

A. THE UTILITY SECTOR

In the utility sector, the supply of piped gas is a privately owned monopoly that is entirely unrestrained by effective competition. Gas supply is not subject to price

7 Such restrictive agreements might be upheld by the reasonable restraint of trade doctrine enunciated in such old common law cases as Mitchel v. Reynolds, 24 Eng. Rep. 347 (K.B. 1711) and Nordenfeld v. Maxim Nordenfeld Guns and Ammunition Co., [1884] App. Cas. 535.

regulation and there is no network access regime. Consequently, the gas supply company is highly profitable and is not subject to any competitive restraint. The gas monopoly is controlled by one of the local property-based conglomerate.

Electricity is supplied by two private firms. The smaller one, Hong Kong Electric, is part of the real estate-based Hutchinson-Whampoa/Cheung Kong property conglomerate. The larger one, China Light and Power, is probably Hong Kong's most significant monopolist. Each firm has a geographic monopoly over separate parts of Hong Kong's very small territory. Both companies are signatories to voluntary schemes of control whereby they agree, with the government, to limits on tariffs that yield them guaranteed rates of return of between 13.5 and 15 percent per year. They are not subject to competitive pressures or mandatory access regimes.[8]

The incumbents have responded to complaints about high prices with a propaganda campaign claiming that opening the distribution grid to competition would adversely affect the security of supply. An ongoing periodic review of the schemes of control by the government is unlikely to yield any significant changes. The creation of a third-party access regime that would facilitate the creation of a market in electricity seems unlikely. To court populism, the government may attempt to enforce a lower rate of return, but even this is still uncertain. Huge sunk costs and the physical limitations of both the supply of gas and electricity plainly make it impossible for new players to enter either market. The monopolists' positions in both these utility markets appear to be unassailable.

B. PRICE-FIXING AT THE PORTS

The seaport was the principle reason for the British seizure of Hong Kong in the 19th century. It was one of the few deep-water, typhoon-sheltered anchorages along the southern coast of China. The port remains one of the world's busiest container terminals, but the vast majority of its throughput originates in, or is destined for, mainland markets, not domestic Hong Kong consumption. Approximately 20 million containers are handled annually but growth has been slowing in recent years due to several factors discussed later in this paper. The port is owned by two local, property-based companies Hutchinson-Whampoa and Warf Holdings, which control approximately 80 percent of the traffic, and by Dubai's DP World and Singapore's port monopolist, which controls the other 20 percent.

Hong Kong has the highest terminal handling charges (THCs) in the world. Port operators set the THC with shipping lines which charge the freight shippers the THC in addition to freight rates. The calculation of the THC is not transparent and shippers suspect that there is a high profit element split between the

8 For details of the Schemes of Control, *see* HK Electric, *Scheme of Control Agreement* (May 6, 2005), *at* http://www.hec.com.hk/hehWeb/AboutUs/SchemeOfControlAgreement/Index_en.htm (last visited Oct. 4, 2007).

port operators and the shipping lines. It is well-known that THC rates and cargo handling capacity utilization are set among the three port Hong Kong operators. In a 2005 *Financial Times* article, the managing director of the largest operator admitted to this price-fixing and capacity arrangement when the ownership of one of the smaller operators changed and the incumbents were anxious that the new owner would destabilize the existing cartel arrangement.[9] But cartels are lawful in Hong Kong and the government has no power to investigate or sanction such arrangements.

New port facilities immediately to the north of Hong Kong in the Pearl River delta create uncertainty for the future of Hong Kong's port. Most of the cargo handled by the Hong Kong port originates in, or is destined for, this manufacturing hub, and land transport of containers to the new, more proximate ports is considerably less costly than trucking the goods to Hong Kong. Shipping the goods through Hong Kong involves two sets of customs procedures as strict border controls exist between Hong Kong and the mainland. Terminal handling charges are also substantially lower at the mainland ports, reflecting the much lower costs of land and wages in the mainland compared to Hong Kong.

Until recently, the mainland ports were less efficient than Hong Kong and had less international connectivity, but these deficiencies are being addressed as container volumes increase and more shipping lines call at these new ports. Interestingly, both of the major Hong Kong port operators also have large equity stakes in the new mainland ports through various joint ventures with local mainland governments and state-owned shipping firms. As a result, the incumbents have a substantial conflict of interest in maintaining the competitive position of the Hong Kong ports. While they will continue to extract as much profit from their Hong Kong operations as they can, if the Hong Kong port declines over time, then the redundant prime waterfront sites could be easily redeveloped by their real estate-developer parent companies.

Both the existing structure and the behavior of the existing port operators need to be addressed in order to maintain the Hong Kong port's competitiveness, but it is a moot point as to whether the proposed competition law will have appropriate powers to deal with the relevant issues.[10]

C. THE RETAIL SECTOR

Turning to the retail sector, two incumbents, Park'nShop and Wellcome, dominate approximately 80 percent of the supermarket sector in Hong Kong. The

9 *Quoted in* Russell Barling, *End the Apathy, Mr. Tsang, and give our port a chance*, SOUTH CHINA MORNING POST, Feb. 3, 2006.

10 For an analysis of some of the issues facing the port, *see* ECONOMIC DEVELOPMENT AND LABOUR BUREAU, STUDY ON HONG KONG PORT – MASTER PLAN 2020 (2004), *available at* http://www.pdc.gov.hk/eng/plan2020/pdf/annex.pdf.

Hutchinson-Whampoa real estate conglomerate is the parent of the Watson's retail group. This entity controls Hong Kong's leading electrical retailer, Fortress, the leading personal care chain, Watson's, and the largest supermarket chain, Park'nShop. Wellcome is owned by Dairy Farm, the retail subsidiary of the local Jardine Matheson conglomerate. Supermarkets in Hong Kong are small by international standards and the local market has significant idiosyncrasies. Most shoppers buy only what they can carry home from the stores since 90 percent of Hong Kong residents do not own automobiles. Grocery shopping is done on a daily basis, especially for fruit, meat, and fish, because of limited storage capacity in cramped Hong Kong kitchens and a cultural preference for fresh produce. Most supermarkets are within the vicinity of large condominium developments, where the vast majority of the population live (houses are the preserve of the very rich or of traditional village dwellers). Supermarkets in Hong Kong are not located on standalone sites with extensive parking lots. These peculiarities of the local market, along with site scarcity, determine market structure.

Both organic growth and the acquisition of sites enabled the two incumbents to attain their dominant positions. International grocery retailers have attempted to enter the local market, but have failed to gain sufficient sites to make operations viable. Allegations have surfaced that landlords affiliated with the two main players were reluctant to lease premises and that all available sites were already occupied. Hong Kong's urban area is extremely densely packed and large retail sites are very rare. Carrefour, the French grocery giant, opened and then withdrew from the local market in the 1990's citing these constraints. Later it alleged that the incumbents were unhappy that Carrefour might sell at discounted prices. Allegedly, suppliers, either voluntarily or at the behest of the incumbents, applied commercial pressure by threatening to deny supplies of merchandise unless retail price maintenance was adopted to ensure that price competition was suppressed.

Another example of alleged abuse of dominance occurred when a new market entrant, Ad Mart, sought to adopt a no-store Internet and telephone ordering service with free home delivery. This new entrant was allegedly forced out of business by the actions of the two incumbents. Selective price-cutting and pressure on suppliers not to deal with Ad Mart forced the closure of the newcomer within nine months. Such practices are lawful, however, and no investigation of the allegations was undertaken. The Hong Kong Consumer Council has made allegations of price-gouging against the incumbents, but the firms have resolutely denied price-fixing or any collusive conduct and, in any event, the government is powerless to determine the facts or take any action given the lack of a general competition law.[11]

11 For an analysis of the supermarket sector in Hong Kong, *see* Mark Williams, *The Supermarket Sector in China and Hong Kong: A Tale of Two Systems*, 3(2) COMPETITION L. REV. 251 (2007), *available at* http://www.clasf.org/CompLRev/downloads/Vol3Issue2.htm.

D. PETROLEUM PRODUCTS

The supply of petroleum products has generated substantial controversy over the years in Hong Kong. The market for fuel for private vehicles is small and highly concentrated as less than 10 percent of the Hong Kong population owns an automobile. The supply of motor fuel was investigated by government-appointed consultants in an attempt to discover if the lack of price competition results from the inherent oligopolistic structure of the market or whether actual collusion between suppliers takes place. Unfortunately, the study was fundamentally flawed as the investigators had no legal power to obtain evidence or question the parties. As a result, the investigating legal firm delivered an unsatisfactory report that could only rely on publicly available information or information that was provided voluntarily by the oil companies. Unsurprisingly, the report concluded that there was no evidence of actual collusion, despite the absence of price competition.[12]

E. CONSTRUCTION AND CARTELS

The construction industry in Hong Kong is widely suspected of engaging in extensive cartel activities. In 2005, the government attempted a criminal prosecution of a bid-rigging cartel that supplied iron gate sets for public housing units. The cartel was alleged to be a fraudulent criminal conspiracy at common law.[13] The participants did not dispute the existence of the bid-rigging ring, but denied dishonesty, an essential element of the offense. They maintained that they had received legal advice, had a commercial contract drawn up to regulate the consortium's activities, and had at no stage considered that they were acting unlawfully. Their lawyer gave confirmatory evidence at their trial. The judge dismissed the charge on the basis that the contractors honestly believed that they were not acting unlawfully, and that the prosecution could not provide evidence of the necessary dishonest intent.[14]

The supply of cement is also suspected to be cartelized, as are many other industries. The noodle manufacturers association sometimes announces uniform price increases.[15] The driving instructors association has attempted to set minimum prices for lessons on the basis that pernicious competition between instructors, and a declining market, was causing income reductions for instructors.[16]

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12 Economic Development and Labour Bureau, Study of the Auto Fuel Retail Market (Dec. 31, 2005), *available at* http://www.compag.gov.hk/reference/fuel.pdf.

13 HKSAR v Chan William Cheu-hung and Others (DCCC 132 / 2005, District Court, March 16, 2005) (Wright J.).

14 *See id*.

15 *Consumers pay the price for HK's 'Free' Economy,* South China Morning Post, Jan. 6, 2005.

16 Polly Hui, *Driving school cartel stifling competition*, South China Morning Post, Apr. 8, 2005.

F. LAND SUPPLY

The supply of new private apartments is controlled by a tight oligopoly. Four main suppliers dominate the market, supplying over 80 percent of new apartments. The manipulation of apartment prices with tactics that artificially inflate sales and create a false market is common. The industry is also riddled with unfair trade practices such as deceptive calculations of usable floor area, which are virtually unregulated. Consumer protection laws are weak and the government refuses to enact stronger legislation. Coordination between sellers is also thought to exist to maintain price levels by inducing artificial scarcity. The two largest suppliers of apartments have the market power to independently set prices. Bid-rigging at government land auctions also takes place, as described earlier in this paper. The developers are able to influence or dictate government land supply and provision of public housing programs to ensure that prices, and therefore profits, are not depressed. Government stabilization measures during the great asset-price deflation from 1997 to 2003 attempted to cut off the supply of land and new public-sector units for sale to drive prices up. The government and the developers are intimately connected.

G. OTHER SERVICES

In the professional services sector, the medical association examination for foreign-trained doctors who wish to practice in Hong Kong has a very low success rate and may well be a disguised barrier to entry to protect local doctors' fee income. In the air-passenger market, it is suspected that a cartel operates at the wholesale level, though this has not been investigated by the public authorities.

Government procurement and the disposal of public assets (especially land), licensing schemes, and direct governmental participation in certain markets also distorts competition. For instance, funeral services in Hong Kong are provided by private firms, but they must be conducted from two large licensed premises owned by the government. Periodically, leases for funeral halls within these premises are auctioned. In the last round of auctions, the relevant department sold the leases on offer to the highest bidder, who was also the existing dominant operator in the market. This firm's existing position of market power was considerably increased so that it now controls over 70 percent of the funeral services market. As a result, it is likely also able to act independently of rival suppliers that hold very small market shares compared to the dominant undertaking. The effect on competition in the market was ignored—only the amount of revenue the government would reap was considered in the auction process.[17]

Government intervention in markets also has a propensity to create monopolies. For example, all trade exhibition facilities in Hong Kong are government-owned and operated, foreclosing this market to private firms completely. In

17 Sherry Lee, *Funeral threat to take over prices*, SOUTH CHINA MORNING POST, Dec. 8, 2006.

another case, the government took an equity stake in a trade logistics software company granting it a long-term monopoly in the electronic trade facilitation and customs clearance market. Legal gambling, as permitted by statute, is monopolized by a private institution, the Hong Kong Jockey Club. All other gambling is criminalized. As a result, government action directly creates and maintains some commercial monopolies for no apparent economic rationale.

International cartels affect Hong Kong markets in much the same way that they affect markets in other countries. Consequently, major construction projects, the supply of pharmaceuticals, heavy engineering machinery, and international air and sea transport are likely to be affected. Many of these cartels will increase public spending by applying higher-than-market costs to government procurement as well as directly affecting consumers. At present, the government is powerless to protect the public revenue or the consuming public from such abuses.

These examples demonstrate some of the competition problems faced in Hong Kong. Despite these obvious deficiencies in the competitive environment, there is intense skepticism, and often outright hostility, to the enactment of a general competition law by many business figures and industry associations in Hong Kong. They publicly claim that such legislation is an unnecessary and unjustified intrusion on their commercial freedom. They also fear government interference in their business operations and the specter of additional governmental control. However, this hostility is often contrived and irrational. In reality, business dislikes the notion of a competition law and simply desires the maintenance of the status quo to ensure that the intensity of domestic competition is suppressed so that incumbents can maintain existing levels of profitability. The next section outlines the contemporary competition debate and the development of policy in this area.

DESPITE THESE OBVIOUS DEFICIENCIES IN THE COMPETITIVE ENVIRONMENT, THERE IS INTENSE SKEPTICISM, AND OFTEN OUTRIGHT HOSTILITY, TO THE ENACTMENT OF A GENERAL COMPETITION LAW BY MANY BUSINESS FIGURES AND INDUSTRY ASSOCIATIONS IN HONG KONG.

IV. Pro-Competition Policy Development

The current policy debate commenced in 1992 when Lord Patten, the last British governor of Hong Kong, suggested that restrictive business practices might be harming Hong Kong's competitiveness. He initiated a number of sectoral inquiries to be carried out by the Consumer Council that culminated in a report on whether a competition law should be adopted and, if so, what kind would be most appropriate. The Consumer Council was, and still is, a statutory body funded by the government that had no mandatory powers to demand documentary evidence or to interrogate witnesses. The Council set about its work over the next four years and produced reports on various business sectors including banking, residential housing, supermarkets, domestic fuel supply, broadcasting, and telecommunications. The methodologies employed may have lacked investigatory powers, but nonetheless, significant competition failures were found. A final report issued in 1996 recommended the enactment of a comprehensive, cross-sector competition law.[18]

During the same period, the government took active measures to liberalize the monopolized telecommunications sector. The incumbent, Cable and Wireless, had a private, unregulated monopoly of all internal and external circuits. The introduction of pagers, and later mobile telephony, ate into its monolithic structure. The government created a telecommunications authority to oversee market liberalization through a licensing regime that impeded the dominant incumbent from destroying nascent competitors, subjected it to price control, and also to pro-competition licensing conditions. Other operators' licenses contained similar prohibitions against abuse of dominance and cartel activities as well. Broadcasting was also subjected to market liberalization and a pro-competition regulatory regime.

The government's response to the Consumer Council's final report did not emerge until December 1997, more than five months after the retrocession of Hong Kong's sovereignty to the People's Republic. The Patten administration probably would have endorsed the report and proceeded with comprehensive competition legislation given its record in the telecommunications and broadcasting sectors, but the new administration, headed by a scion of one of the most important tycoon families, Tung Chee-wah, resolutely rejected the case for a cross-sector competition law. The government claimed that competition problems in Hong Kong were few, expressed skepticism that such laws were beneficial—especially in the particular context of Hong Kong, and questioned the need for anything more than an exhortation to businesses to abide by fair competition rules. The government offered a vague promise of sector-specific regulations, if necessary, in industries where egregious competition abuses could be proved to be causing serious economic damage. The government also set up the ad hoc interdepartmental committee, COMPAG, to monitor developments, promote the benefits of competition, and receive complaints.

COMPAG proved to be a toothless tiger. The committee promulgated exhortatory pro-competition policy statements, but received very few complaints. This was not surprising given that it had no staff, expertise, or legal powers to investigate, adjudicate, or sanction breaches of the policy guidelines.[19] On the other hand, commercial retribution for those who did complain was a powerful disin-

18 Consumer Council, *Competition Policy: The Key to Hong Kong's Future Economic Success* (November 1996), *available at* http://www2.consumer.org.hk/trd96/TRD96_E.HTM.

19 *See* Competition Policy Advisory Group, *About COMPAG* (June 8, 2007), *at* http://www.compag.gov.hk/about/ (last visited Oct. 4, 2007).

centive to dissent. Consumer-friendly political parties initiated legislative debates on the issues periodically, but received anodyne, stonewalling responses from ministers. The media highlighted apparent competition abuses on a fairly regular basis, but the government downplayed their importance and maintained the existing policy line. The exception was in the telecommunications sector in which the government responded somewhat differently, proposing and legislating substantive prohibitions with regard to abuse of dominance and restrictive agreements in 2000, and introducing a merger control regime in the sector in 2003.[20] The rationale for its differential treatment was not explained.

Essentially, government hostility to a general competition regime remained until the resignation of Mr. Tung and the assumption of power by his chief lieutenant, Donald Tsang Yam-kuen, in March 2005. Within a week of Tsang taking office the Financial Secretary announced the formation of a new government sponsored committee, the Competition Policy Review Committee (hereinafter the "Committee"), to revisit the existing policy position. The composition of the Committee included the Chief Executive of China Light and Power, various other representatives of businesses interests, and only two (out of thirteen members in total) consumer advocates, raising the specter that the review process was rigged. Despite this skewed membership, in June 2006, the Committee reported in favor of a cross-sector competition law[21] with three caveats:

1. the law should exempt natural monopolies (although natural monopolies were undefined);

2. the law should not contain a merger and acquisition control procedure; and

3. the competition authority should not have any structural divestment powers if the structure of an industry or a particular firm is seen to be having anticompetitive effects.

The Committee favored the formation of rules to prohibit abuse of dominance and anticompetitive agreements, the establishment of a competition authority, and the ability to impose penalties. The Committee did not recommend a particular structure for enforcement or indicate whether an administrative body with investigatory and adjudicatory powers or a prosecutorial agency that would have to prove cases before special tribunal or the ordinary courts would be more appropriate. The Committee did not explain the need for a change of policy or the rationale for its recommendations. After a five-month public consultation period from October 2006 to March 2007, the government announced that it had

20 *See* Telecommunications Ordinance, c. 106 (2007), at §§ 7K, L, M, N & P, *available at* http://www.legislation.gov.hk/eng/home.htm.

21 Competition Policy Review Committee, *Report on the Review of Hong Kong's Competition Policy* (June 2006), *available at* http://www.cedb.gov.hk/citb/ehtml/pdf/speech3/CPRC.pdf.

accepted the recommendation of the Committee to proceed with enacting a cross-sector law, but that the details of the ordinance would be subject to further consultation prior to the introduction of draft legislation in December 2007.[22]

The government has a number of contentious issues to resolve before finalizing the new competition bill. First, Hong Kong is not a democracy. The government does not command automatic majority support in the legislature, but instead, depends on ad hoc coalitions of interest groups to secure passage of legislation. Business constituencies control 50 percent of the Legislative Council seats and effectively wield a veto power over legislation that is considered unfriendly to business interests. Consequently, the passage of legislation is never a forgone conclusion.

Second, the case for natural monopolies exemption is exceptionally weak since, with the exception of the water supply, all of the companies in the utility sector are privately owned and not subject to a regulatory regime. In the absence of competitive pressure or regulatory control, private monopolists have every incentive to favor shareholder profits over the public interest. Indeed, the directors have a fiduciary duty to shareholders to maximize returns on investment to company members, but no corresponding legal obligation to any other stakeholders. Consequently, the argument to exempt private sector natural monopolies has no rational basis and is no more than a political compromise to assuage the opposition of the powerful incumbents.

Third, exempting mergers or acquisitions would clearly create an incentive for cartel operators to combine into single economic entities to avoid the illegality of continuing cartel arrangements. If consolidation proved difficult, alternatively conglomerates could exchange assets (e.g., a tycoon-led firm might swap its ports assets for a rival's retail assets), becoming more dominant in a particular sector, but relinquishing a presence in others. Merger control already exists in the telecommunications and broadcasting sectors and it is logically indefensible to not have a regime in other sectors, if it is accepted that a level regulatory playing field is beneficial. Providing such powers to a regulatory authority is necessary to create a well-functioning and comprehensive, pro-competition system. The best solution is probably to delay introduction of the merger rules until the new system is established, with the possibility of swiftly implementing it should a merger wave develop.

Fourth, the possible lack of appropriate powers for the new competition authority to investigate passive structural impediments to competition and, if necessary, to require divestiture so as to promote competition, significantly weakens the effectiveness of a pro-competition regime. The dominance of a small

22 News Release, Hong Kong Economic and Trade Office, Government Releases Report on Public Consultation on Competition Policy (March 19, 2007), *available at* http://www.hketosf.gov.hk/usa/press/2007/mar07/031907.htm.

number of conglomerates in the Hong Kong economic landscape is probably the single biggest inhibitor of new market entrants. Clearly, such divestiture provisions are complex to administer and fraught with potential difficulties, but they should be available as a last resort in situations in which a behavioral remedy is difficult to apply or impossible to monitor.

At present, it is impossible to say whether the government will act wisely and impartially, or whether the political calculus of assuaging the vested interests will outweigh the public interest in coherent legislation. Passage of the bill, even in an attenuated form, may be a first step along the path to the introduction of a rational and comprehensive system. The temporary sacrifice of an optimal regime may be the price the government has to pay to establish a rudimentary antitrust system in Hong Kong.

A final issue worth highlighting is the matter of the telecommunications and broadcasting sectors. The government has already announced that, in light of technological convergence and international regulatory developments, it intends to unify the substantive law governing these sectors and to create a communications authority to replace the existing sector-specific regulations and administrative bodies. Both of these sectors are currently subject to competition rules, but they are not congruent, either in terms of the statutory language or administrative structure. The issue is whether the new communications authority should assume competition powers or whether the new general competition agency should assume them in the communications sector as well as in all other sectors of the economy.

Existing competition authorities handle this matter in different ways. In the United Kingdom, there is concurrency between the regulatory and competition authorities. In Australia, the competition agency handles communication competition matters itself. Hong Kong has abundant financial resources, but very limited human capital in the competition field. It would seem most appropriate, given Hong Kong's small economy, for competition expertise to be focused in one agency rather than split between two bureaucracies to benefit from economies of scale and scope.

V. Conclusion

The analysis presented in this paper suggests that Hong Kong, while admirable in many ways from a laissez-faire economic perspective, has a number of hidden structural imperfections that prevent competition from taking place at all in some sectors and reduce the intensity of competition in many more. The government's land monopoly, its direct intervention and control of some markets, and some of its regulatory schemes that restrict competition are all cause for concern. While the previous policy of denial and evasion has given way to a tacit acceptance that problems do exist, political influence and the power of vested commercial interests may force the government to propose an unsatisfactory or compromised antitrust regime that will fail to address the important competition issues inhibiting the Hong Kong economy. The development of the ordinance in the next year should reveal whether these concerns are well-founded or not. Whatever the outcome, at least Hong Kong will have the semblance of a general competition regime in place at long last.

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A New Kid on the Block: Korean Competition Law, Policy, and Economics

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A New Kid on the Block: Korean Competition Law, Policy, and Economics

Sang-Seung Yi and Youngjin Jung

For a relatively young agency with only a quarter-century history, the Korea Fair Trade Commission (KFTC) has achieved some remarkable success in cartel enforcement and competition advocacy. However, its track record in enforcing merger control leaves much to be desired and its recent ambitious foray into regulating unilateral conduct by global firms such as Microsoft has received a mixed review. In order to achieve its aspiration to be recognized as a global force in antitrust—for which it has already made significant progress—the KFTC should take measures to encourage private suits, strengthen its economic analysis unit, fundamentally overhaul chaebol (large Korean conglomerates) regulation, establish a "Chinese wall" between its investigative and adjudicative offices and personnel, and reinforce its efforts to guarantee proper procedural rights to defendants. In taking these steps, the KFTC can grow from its current new kid on the block status to a leader in global antitrust.

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I. Introduction

This paper provides two authors' perspectives on the achievements, shortcomings, controversies, and challenges ahead for Korean competition law and policy. The Korean Competition Law, formally known as the Monopoly Regulation and Fair Trade Act (MRFTA), was enacted on the last day of 1980.[1] In the past quarter-century, since its establishment in 1981 as the principal enforcer of the MRFTA, the Korea Fair Trade Commission (KFTC) has achieved significant successes, especially in the area of cartel enforcement and competition advocacy. In recent years, it has accepted economic analysis as the proper basis for determining antitrust violations and has established an economic analysis unit.

The acceptance of economic analysis in competition law matters is not limited to the KFTC. Earlier this year, a Korean court reached a landmark decision in a collusion case in which it based its damages awards on sophisticated econometric estimation.[2] Indeed, the Korean courts have led the KFTC in one important area of applying economic analysis to competition law. In 2004, a Korean court formally applied the critical loss analysis based on the hypothetical monopolist paradigm for defining the relevant market for horizontal mergers—two years before the KFTC followed suit.[3]

Along with these achievements, however, there have been disappointments and controversies. First, in the merger area, the KFTC's role has largely been a "declaratory" one. It has found several high-profile mergers to be anticompetitive, but the imposed remedies have been largely symbolic, although there are encouraging signs that the KFTC is now taking merger control much more seriously. Second, the KFTC's regulation of cross-share holdings and business dealings among the big Korean conglomerates, known as chaebol, is based on rigid formulae that do not take account of actual economic effects.

Third, until recently, the KFTC's enforcement with regard to abuse of market dominance has been anemic. Its recent ambitious foray into this area, which culminated in its 2006 decision against Microsoft's inclusion of digital media playback and instant messaging capabilities in its Windows operating system, has received a mixed review. While the European Commission expressed its support

1 For the Korean MRFTA [hereinafter MRFTA] and other documents, *see* Korea Fair Trade Commission Homepage, *at* http://ftc.go.kr/eng/ (in English) (last visited Oct. 4, 2007). *See* Monopoly Regulation and Fair Trade Act, Law No. 3320 (December 31, 1980), *available at* http://ftc.go.kr/data/hwp/(1)mrfta.doc.

2 Republic of Korea v. SK, Inc. et al., 2001 gahap 10682 (Seoul Central District Ct. Jan. 2007).

3 It is our understanding that since 2002, the KFTC began using consumer survey data on the likely effects of hypothetical price increases on consumer behavior for market definition exercises. However, prior to the Seoul High Court's 2004 decision, the KFTC did not ask if the price increases would be *profitable* for a hypothetical monopolist of the putative market, which is the critical question in defining the relevant market.

for the KFTC's decision, the U.S. Department of Justice issued a formal statement that criticized the KFTC's order to release a version of Windows without these features as potentially harmful to innovation. Both the KFTC's theory of harm and its economic evidence have been vehemently challenged by Microsoft in an appeals court. It remains to be seen if the KFTC's condemnation of technological tying chills innovation—as one author of this article (Yi) and Microsoft believe—or a minimum necessary intervention to restore competition—as the article's other author (Jung) and KFTC claim.

Despite these shortcomings and controversies, it is our overall assessment that the KFTC and the Korean Competition Law have emerged as serious forces to be reckoned with in global antitrust. Since Microsoft, the KFTC has turned its attention to Intel and Qualcomm, as well as leading Korean firms, as potential targets for abuse of dominance investigations. It has actively cooperated with the U.S. Department of Justice and European Commission over international cartel investigations. Developing countries are increasingly looking at the KFTC as a potential role model, on the assumption that they lack institutions needed for the kind of sophisticated antitrust enforcement seen in the United States or Europe.

DESPITE THESE SHORTCOMINGS AND CONTROVERSIES, IT IS OUR OVERALL ASSESSMENT THAT THE KFTC AND THE KOREAN COMPETITION LAW HAVE EMERGED AS SERIOUS FORCES TO BE RECKONED WITH IN GLOBAL ANTITRUST.

Nevertheless, serious challenges lie ahead for the KFTC and the Korean Competition Law. In this article, we identify four of them. First, it is time to fundamentally overhaul chaebol regulation. Ex ante limits on cross-shareholdings among chaebol affiliates based on the vague and ill-defined concept of "concentration of economic power" should be abolished. In its place, enforcement should be strengthened with regard to conventional areas of competition law, such as cartels, mergers, and abuse of dominance. At the same time, other clauses of the MRFTA designed to protect minority shareholders should be taken out and enacted in a separate law (the title that we propose is "A Special Law on the Protection of Minority Shareholders of Large Business Groups") or incorporated into the Corporation Part of Korea's Commercial Code.

Second, although the KFTC has recently achieved remarkable success in identifying cartels using a leniency program, collusive culture is still widespread among Korean firms, fostered by formal and informal administrative guidance directed by various government ministries during the era of government-led growth. In order to combat hard-core cartels more effectively, the KFTC should intensify criminal law enforcement in collaboration with the Prosecutor's Office.

Third, the KFTC needs to relinquish its near monopoly over the enforcement of the Korean Competition Law. The KFTC should embrace competition as the main driving force for development in antitrust enforcement, as it advocates in other areas, and measures should be taken to facilitate private antitrust litigation. For instance, the MRFTA should be amended to allow private parties to file lawsuits seeking injunctions against suspected competition law violators in court (in addition to filing complaints before the KFTC). Class action lawsuits to recover damages by end-user consumers should also be allowed, though rules should be devised to discourage frivolous lawsuits.

Fourth, the KFTC should enhance its efforts to establish itself as a quasi-judicial body with full procedural rights conferred to investigation targets, and to fully develop its economic analysis unit. We are encouraged by the fact that the KFTC has recently been moving in this direction, but it needs to move much faster in order to achieve its aspiration to become a major player in global antitrust.

II. Historical Perspective

Proper understanding of an institution often requires a historical perspective. The unique features (and shortcomings) of the Korean Competition Law and the KFTC are, in large part, the products of Korea's unique history. Hence, we begin with a very brief overview of Korea's economic history in the past half-century, during which Korea has accomplished breathtakingly fast economic growth. Its nominal per-capita GNI (gross national income) has increased 224-fold from US$82 in 1961 to US$18,372 in 2006.[4]

The Korean government has taken an active role in transforming Korea from a backward rural economy into the thirteenth largest economy in the world within the span of five decades. After seizing power in a military coup in 1961, President Jung Hee Park declared that economic growth would be the number one priority of his government and engaged in what could be characterized as an "export-oriented industrial policy." Realizing that Korea lacked natural resources such as oil, President Park determined that the only way to lift Korea out of poverty was to tap the export markets. The Economic Planning Board, which President Park established to implement his export-led growth policy, instituted a series of "5 Year Economic Development Plans" that envisioned a path for growth for Korea that would begin with light manufacturing industries and then move on to heavy manufacturing and service industries.[5] The early Korean industrial policy was unique in that it had a strong market discipline built in. Companies in the government-targeted industries received low-interest (often negative-interest) loans, export subsidies, and tax credits, but only if they successfully competed in the open international markets.

4 In real terms, the annual GDP growth rate averaged 8.16 percent from 1961 to 1990, but as the Korean economy has matured, the annual growth rate has slowed down to 5.61 percent from 1991 to 2006. Bank of Korea, Economic Statistics System, *at* http://ecos.bok.or.kr (last visited Aug. 17, 2007).

5 In 1982, the Korean government changed the name of the "5 Year Economic Development Plan" to "Economic Social Development Plan" and the planning elements were largely dropped.

Beginning in the mid 1970's, Park's government steered the Korean economy into heavy equipment manufacturing and petrochemical industries as the next step in the government-led economic growth plans. Large-scale investments in these industries were carried out by a handful of family-controlled large conglomerates, known as chaebol, that continue to dominate the Korean economy to this day. This period also produced the too-big-to-fail syndrome. Encouraged by government subsidies and below-market-rate loans, some chaebol made huge investments in heavy industries financed by enormous debt. Out of the fear that allowing unprofitable chaebol to go bankrupt would trigger a chain reaction throughout the entire economy, the Korean government continued to bail them out. Under this policy environment, it was rational for chaebol to choose very risky, large-scale investments with little consideration of profitability. If the investments turned out to be profitable, chaebol reaped the benefit. If the investments failed, then the chaebol could count on more-or-less certain government bailout. These investments contributed to outward growth in the 1980's and 1990's, but sowed the seeds for the deep economic crisis that gripped the Korean economy in 1998 when the Asian foreign exchange crisis in late 1997 exposed the vulnerability of many chaebol.

Throughout this entire period, especially before 1980, competition law was perceived as a luxury that Korea could not afford. When calls were made to introduce a competition law following the public uproar over collusion by leading chaebol on such household necessities as sugar and flour in the 1960's, Park's government decided that economic growth was more important than consumer welfare. Repeated calls throughout the 1970's for a competition law were ignored by Park's government on the ground that Korea was not yet ready.[6] Intense lobbying by chaebol played no small part in blocking the enactment of a competition law. It is telling that only after another coup in 1980, did the new military government pass the MRFTA.[7]

The historic enactment of the Korean Competition Law reflected an increasing consensus among policymakers and leading academics that Korea needed to make a transition from a government-led regime based on industrial policy to a more market-oriented regime based on competition policy.

When it was established in 1981, the KFTC began, humbly, as a division within the Economic Planning Board. Over time, it has grown into one of the most important agencies in the Korean government. It became an independent, vice-ministerial agency under the direct auspices of the Prime Minister in 1994 and

6 For a more detailed discussion of Korea's early attempts to introduce competition law, *see* Youngjin Jung & Seungwha Chang, *Korea's Competition Law and Policies in Perspective*, 26 Nw. J. Int'l L & Bus. 687, 688-94 (2006).

7 In 1987, Korea made a peaceful transition to democracy.

was elevated to the level of ministerial agency in 1996.[8] The key impetus for the increasing authority and power of the KFTC was the dominance of chaebol over the Korean economy. In order to curb the expansion of chaebol, the MRFTA was revised in 1986 to include direct controls over the total amount of equity investments by chaebol and a prohibition of holding companies. As a result, the KFTC has become the powerful regulator of chaebol, as well as the enforcer of more traditional competition law. Indeed, the KFTC is more widely known as the chaebol regulator among ordinary Koreans. But, following the economic crisis in 1998, the KFTC has greatly stepped up its enforcement of competition law, as we elaborate in the following sections.

III. Basic Features of Korea's Competition Law

Historically speaking, competition law began as an Anglo-American institution. In Japan, the U.S. occupation force, led by General MacArthur, introduced competition law after World War II, but its main purpose was to dissolve and prevent the resurgence of the zaibatsu, the family-controlled large conglomerates that financed the Japanese war machine. The same U.S. force that liberated South Korea from Japanese colonial rule saw no such need, in large part because chaebol were yet to emerge in Korea.[9] Korea lived without a competition law for the next thirty-five years. When the Korean government finally enacted the MRFTA in 1980, it was modeled after the Japanese law, as many Korean administrative laws at that time were. As a result, the statutory framework of the Korean MRFTA is quite similar to that of the Japanese Antimonopoly Law.[10]

However, the statutory similarity belies the fact that the two laws have significant differences in practice. One of the interesting features of Korean competition law and practice is the extent to which the jurisprudential developments in U.S. and EC competition law have influenced Korean competition law and policy. Cases and economic theories that evolved in the United States and the European Community have been routinely referenced in the briefs filed with the KFTC and the courts. This practice facilitates international judicial communication and has served as the basis for a more mature and sophisticated develop-

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8 KOREA FAIR TRADE COMMISSION, A TWENTY-YEAR HISTORY OF THE KFTC (2001) (in Korean). In 1994, the Economic Planning Board was dissolved. Part of it became Ministry of Planning and Budget and the rest was absorbed by the Finance Ministry.

9 The pre-war zaibatsu in Japan and the post-war chaebol in Korea resemble each other in that they are family-controlled conglomerates.

10 One exception is that the former has embraced the concept of abuse of market dominance whereas the latter has adopted the concept of monopolization. In order to see the statutory similarities and differences from the Japanese Antimonopoly Law, *see* The Act on Prohibition of Private Monopolization and Maintenance of Fair Trade, Act No. 54 (April 14, 1947) (in English), *available at* http://www.jftc.go.jp/e-page/legislation/ama/amended_ama.pdf.

ment of Korean competition law and practice.[11] At another level, it is our opinion that in recent years, the KFTC has been more active than the Japan Fair Trade Commission (JFTC) in three key areas: cartels, competition advocacy, and abuse of dominance.[12]

Three key features set Korean competition law and policy apart from antitrust law in the United States. First, as mentioned above, the Korean Competition Law entrusts the KFTC with the primary responsibility to enforce the law. The Prosecutor's Office may enforce Korean competition law with respect to criminal liability, but only if the KFTC refers the matter to it. In practice, the referral to the Prosecutor's Office has been limited to cases involving hard-core cartels.

The courts play a role mainly in two ways. One is when a defendant challenges a KFTC decision before the Seoul High Court, which has exclusive jurisdiction over the appeal of a decision by the KFTC. The courts also adjudicate private antitrust suits—currently limited to damages suits—which do not have to rely on actions by the KFTC. In the past, it was not common for firms to challenge a government agency's decisions in court, because the agency would typically have subsidies, tax credits, and other policy tools at its disposal. Government agencies typically implemented industrial policy to develop "strategic" industries, but at the same time regulated competition, and sometimes directly imposed price controls. After becoming an independent agency, the KFTC has had a single mandate—to enforce the MRFTA. As a result, firms are increasingly willing to challenge the KFTC's decisions in court, especially when a big amount of administrative surcharges is involved.[13]

On the other hand, private antitrust litigation is not a potent force in Korea, mainly because the MRFTA does not allow private parties to file for an injunction against suspected MRFTA violations directly in court and because class action lawsuits are not permitted in antitrust matters. As we elaborate below, we

11 For more discussion on this point, *see* Youngjin Jung, *Transjudicial Communications in International Competition Law: The Korean Competition Agency's Landmark Microsoft Decision*, 10 INFOMEDIA L.J. 19 (Fall 2006) (in Korean).

12 An industry review magazine shares our assessment. According to the Rating Enforcement of Global Competition Review, the KFTC was ranked as the top rated competition authority in Asia, ahead of the JFTC in 2006. For details, *see* Rating Enforcement, GLOBAL COMPETITION REV. (Jun. 10, 2007), *available at* http://www.nmanet.nl/Images/Global%20Competition%20Review%20Rating%202006_tcm16-103767.pdf.

13 The ratio of the court challenges with respect to KFTC's adverse decisions is not high. Still, the willingness of Korean firms to challenge the KFTC's decisions in court is in sharp contrast to the experiences with other Korean regulators such as the Broadcasting Commission and the Telecommunications Commission. The Broadcasting Commission and the Ministry of Information and Communications (of which the Telecommunications Commission is a part) have large budgets and other policy tools over the regulated firms. As a result, the decisions by these two commissions are rarely challenged in court, in large part because the regulated firms fear that challenging the regulator would have adverse consequences in other areas.

believe that this is one area that needs urgent attention in order for Korean antitrust law to take another leap forward.

In sum, it could be argued that the KFTC is currently the single, most important enforcer of Korean competition law. The KFTC's quasi-monopoly of enforcement of Korean competition law is distinct from the U.S. antitrust law, in which various stakeholders such as individuals and state governments may also initiate actions to enforce U.S. antitrust law.

Second, as with competition laws in other jurisdictions, the MRFTA declares that the promotion of "fair and free competition" as its overall objective. However, another goal of the MRFTA is "to strive for balanced development of the national economy by preventing . . . the excessive concentration of economic power."[14] In this regard, Korean competition law differs from U.S. competition law, which arguably purports to maximize economic efficiency and consumer welfare. The Japanese Antimonopoly Law also sets "preventing the excessive concentration of economic power" as an objective, but the dominance of chaebol over the Korean economy has compelled the KFTC to implement far more stringent regulations, including complete prohibition of debt guarantees among chaebol affiliates.[15]

Nevertheless, after the economic crisis in 1998, the KFTC devoted increasing amounts of resources to enforcing the traditional aspects of competition law. We expect that the KFTC will continue its transformation from chaebol regulator to a competition authority in the more traditional sense. One impetus for the continuing shift in policy is the international effort to harmonize competition laws. For example, the Competition Chapter of the Korea-U.S. Free Trade Agreement (FTA), signed in June 2007, states:

WE EXPECT THAT THE KFTC WILL CONTINUE ITS TRANSFORMATION FROM CHAEBOL REGULATOR TO A COMPETITION AUTHORITY IN THE MORE TRADITIONAL SENSE.

> "Each Party shall maintain or adopt competition laws that promote and protect the competitive process in its market by proscribing anticompetitive

14 The full text of Article 1 ("Purpose") of the MRFTA is as follows:

> The purpose of this Act is to promote fair and free competition, to thereby encourage creative enterprising activities, to protect consumers, and to strive for balanced development of the national economy by preventing the abuse of Market-Dominant Positions by enterprisers and the excessive concentration of economic power, and by regulating improper concerted acts and unfair business practices.

MRFTA, *supra* note 1, at art. 1.

15 *Id*. at art. 10-2.

business conduct. Each Party shall take appropriate action with respect to such conduct with the objective of promoting economic efficiency and consumer welfare.”[16]

Third, Korea has adopted a civil-law system as opposed to a common law system. Therefore, it maintains a fairly elaborate statutory framework, which places limits on judicial lawmaking. As a result, the KFTC and Korean courts routinely confront issues that have not been dealt with in U.S. antitrust law. For instance, in the *Microsoft* case, the court has to deal with the fact that most media players and messengers are apparently provided for free, because while the provision on abuse of market dominance does not explicitly require "positive" pricing, the provision on unfair trade practices stipulates that the transaction that is alleged to constitute tying be done for a positive price. Under the provisions of the MRFTA, therefore, if the product is, indeed, free, then the courts will have to find a rationale to get around the statutory requirements as far as the provision on unfair trade practices is concerned.[17]

More generally, because the Korean legal system basically follows the European civil law system, some Korean legal scholars and practitioners argue that the MRFTA does not lend itself to U.S.-style antitrust enforcement tools such as treble damages and class actions. It is true that the Korean civil law is not amenable to the concept of punitive damages such as treble damages. However, class action is just a procedural facilitator for private litigation. Hence, it is a matter of policy whether to introduce class action in the Korean legal system. In the area of securities litigation, class action lawsuits have already been introduced (albeit in a very limited scope). There is no compelling reason why class action lawsuits cannot be introduced for antitrust matters as well.

The consent decree is another procedural innovation Korea has decided to borrow from the United States. As part of its continuing efforts to modernize the Korean Competition Law, the KFTC proposed a revision of the MRFTA in late 2006 which, among other things, included the introduction of consent decrees.

16 United States-Korea Free Trade Agreement (draft of Jun. 30, 2007) (not yet in force), *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Final_Text/Section_Index.html. Chapter 16 of the Agreement addresses "competition related matters."

17 In its Decision, the KFTC ruled that whether or not the tied good in question is provided for free is irrelevant for "coerced purchase." KFTC Decision 2006-042, 127-129, Concerning Abuse of Market Dominant Position, etc. by Microsoft Corporation and Microsoft Korea Yuhan Hoesa [hereinafter *Microsoft*] (Feb. 2006) (in Korean). From an economic point of view, the first author of the current paper (Yi) believes that because media players and messengers can be downloaded easily for free using broadband Internet, pre-installation of Windows Media Player and Microsoft messengers do not prevent consumers from acquiring competing media players and messengers and thus have little foreclosure effects. This issue should be resolved with empirical data, over which the KFTC and the second author of the current paper (Jung), and Microsoft and the first author (Yi) have sharply different views.

However, due to the objection of the Ministry of Justice, the revised bill of April 2007 omitted a provision for consent decrees. However, as part of the FTA, the U.S. and Korean governments agreed to introduce consent decrees to the MRFTA. The revised legislation, proposed by the KFTC in August 2007, calls for explicit consultation with the Attorney General as well as other interested parties in the 30-day public consultation period.

IV. Cartels

Cartel enforcement is arguably the single most significant achievement of the Korean Competition Law since its enactment in 1980. In a landmark decision in 2000, the KFTC found five oil refineries liable for colluding in bidding on military oil and levied a record surcharge of 190 billion won (over US$200 million under the current exchange rate).[18] In our view, this was a watershed decision that signaled that the transformation of the KFTC from chaebol regulator to traditional competition authority had begun in earnest.

Based on this finding of liability, in 2001 the Ministry of Defense filed a damages lawsuit for 158 billion won. On the joint recommendation of both the plaintiff and the defendants, in 2003 the Seoul Central District Court appointed a group of economists to assess the appropriate damage award.[19] They employed a sophisticated econometric model to estimate the damages. After considerable scrutiny by the defendants over all aspects of the estimation ranging from data to model specification, in 2007 the district court accepted most (but not all) of the analysis done by the court-appointed experts.[20] This decision is widely commended as heralding the acceptance of economic analysis in antitrust by the Korean courts. Like other Korean observers, we are impressed by the court's ability to digest the complex econometric model, narrow down the key issues, and reach (in our opinion) a sensible decision.[21]

18 KFTC Decision No. 2000-158, Concerning improper concerted acts by five oil refineries in military oil bidding in 1998, 1999, and 2000 (Oct. 2000) (in Korean). This amount is more than twice the combined (nominal) amounts of all surcharges on cartels since 1981. The KFTC later reduced the surcharge to 121 billion won on the grounds that some defendants (both the companies and individuals) were indicted (on which they were later sentenced to pay criminal fines) and the Ministry of Defense filed a damages lawsuit that we discuss in the main text.

19 The first author of the present article (Yi) was one of the court-appointed experts affiliated with the Center for Corporate Competitiveness of the Institute for Economic Research at Seoul National University.

20 Republic of Korea v. SK, Inc. et al., 2001 gahap 10682 (Seoul Central District Ct. Jan. 2007). After deducting 9 billion won for oil supplied for free in 1998, the final amount that the defendants were ordered to pay was 81 billion won. The court-appointed experts' original estimation was 105 billion won (after the deduction).

21 For another commentator who is "moved" by this decision, *see* Sun Hur, *Let's Discuss the Evidentiary Value of Economic Analysis in Fair Trade Cases*, 132 J. Competition 3 (May 2007) (in Korean).

The KFTC has continued to step up its enforcement activities against cartels. Several noteworthy changes took place in 2005. First, the revised MRFTA went into effect, raising the maximum level of surcharges on cartels from 5 percent to 10 percent of the enterprise's average turnovers for the three previous years.[22] Second, the KFTC's cartel team was expanded into a new Directorate, the Cartel Bureau. Third, the leniency program was reformed to guarantee mandatory surcharge reductions to the first two cartel members who report their illegal collusive behavior to the KFTC (100 percent to the first informer and 30 percent to the second), provided certain statutory conditions are met.[23]

Combined together, these reforms have been very successful. From flour to sugar to petrochemicals to fire insurance, former cartel members have rushed to become the first to report their wrongdoing to the KFTC to qualify for the reduced surcharges. However, the way the leniency program is administered has created some controversies, because of the accusations that cartel organizers were often the beneficiaries of the program. Amid a mounting criticism of the legitimacy of the leniency program based on social justice concerns, the KFTC announced the revision of the Executive Decree in August 2007, providing that the companies which "force" other firms to participate in the cartel will no longer be eligible for leniency.[24] The KFTC's increasingly aggressive enforcement actions are laudable and have greatly contributed to breaking through the ingrained collusive culture among Korean businesses.

Cartel enforcement is often mentioned as the area where the convergence of different antitrust regimes has been most significant. We are pleased to see that Korea has been an active participant in this convergence. For example, the KFTC has been active in applying the MRFTA extraterritorially to foreign cartels, beginning with an 11 billion won surcharge on the graphite electrode cartel in 2002 and a 4 billion won surcharge on the vitamin cartel in 2003. The Korean Supreme Court has rejected the challenge by the defendants in the graphite electrode cartel case based on the lack of a specific clause in the

22 Because private damages suits and criminal enforcement are not very prevalent, the administrative surcharge is the most potent deterrent to cartel formation in Korea. The revision history of the maximum allowed surcharges on cartels nicely illustrates the increased emphasis that the KFTC has put on enforcing the traditional competition law (as opposed to chaebol regulation). The original MRFTA of 1980 had *no* surcharge clause regarding cartels. The first revision of the MRFTA in 1986 introduced a modest level of one percent of relevant sales and in 1994, the maximum level was raised to five percent.

23 Korean courts have also stepped up criminal sanctions against hard-core cartels. In 2007, a court handed down the first prison sentences (sentenced for one year, suspended for two years) for the executives who formed a cartel on detergents.

24 At the same time, the second informer will receive 50 percent reduction (increased from the current 30 percent) in surcharges. For details, *see* Press Release, Korean Fair Trade Commission, Announcement for the revision of the Executive Decree of the MRFTA (August 10, 2007) (in Korean), *available at* http://www.ftc.go.kr/new_content/info/info_023v.php?ymd=2007-08-10&no=0011&ddcode=&av_pg=&ref_val=&mode=&field=&qrytext=&sDate=&eDate=.

MRFTA authorizing the extraterritorial application of the law.[25] In order to eliminate any lingering uncertainty, in 2004 the MRFTA was revised to include an explicit provision (Article 2-2) that allows for extraterritorial application of the MRFTA based on the so-called "effects doctrine."[26]

In order to take the next leap forward in cartel enforcement, however, we believe the Korean Competition Law needs two changes. First, in close collaboration with the Prosecutor's Office, the KFTC should be given criminal law enforcement tools to use against hard-core cartels. Currently, investigation targets can refuse to cooperate with the KFTC's investigators.[27] Of course, many firms voluntarily cooperate with the KFTC out of the fear that failure to do so will have negative consequences when the KFTC exercises its discretion in setting the surcharges based on the (lack of) cooperation of respondents. That said, given that the KFTC is the primary enforcer of Korean competition law, it should be endowed with proper investigation tools. The KFTC should cooperate with the Ministry of Justice in order to find a mutually agreeable middle ground and secure strong investigation powers.

Second, an oddity of the Korean Competition Law is that Article 19-5 of the MRFTA allows the statutory presumption of illegal agreements based on parallel actions. In a 2003 ruling, the Korean Supreme Court held that the presumption within the meaning of Article 19-5 obviates the need for any additional demonstration of circumstantial evidence that would indicate the agreement or tacit understanding among enterprises.[28] This statutory presumption clause, which was added to the MRFTA in 1986, might have been necessary in the past in order to alleviate the evidentiary burden on the young agency. However, the KFTC now accepts the economic theory that parallel behavior among oligopolistic firms may arise naturally. We are pleased that the KFTC's proposed changes to Article 19-5, which require so-called plus factors, were passed by the National Assembly of Korea in July 2007. Specifically, the amended Article 19-5 of MRFTA stipulates that agreement for cartel is presumed if there is a considerable likelihood that the enterprises have jointly engaged in the alleged acts in light of all the circumstances, including characteristics of the relevant line of business or product or service, economic reasons or impact of the relevant act, and frequencies and patterns of contacts among the firms. This is very similar to facilitating or plus factors identified in U.S. case law. This amendment is certainly a step forward in the continuing modernization of Korean competition law.

25 Showa Denko KK v. KFTC, 2004 du 11275 (Supreme Ct. 2006). For more discussion on the extraterritorial application of the MRFTA, *see* Youngjin Jung, *Korean Competition Law: First Step Towards Globalization*, 4(2) KOREAN L.J. 177 (2005).

26 For the effects doctrine, *see* Hartford Fire Insurance Co. v. California, 113 S. Ct. 2891 (1993).

27 Currently, refusal to cooperate with a KFTC investigation can only be punished by negligible civil fines.

28 Hite Beer v. KFTC, 2001 du 946 (Supreme Ct. Feb. 2003).

It also happens that the success of the revised leniency program has obviated the need for the KFTC to resort to Article 19-5, and instead, has allowed the agency to directly apply Article 19-1 (which mainly applies when there is direct evidence of agreement) in several important recent cases. At the same time, however, the KFTC's recent tendency to rely on Article 19-1 of MRFTA, even when direct evidence is scarce at best and dubious circumstantial evidence is scattered, is worrisome.[29] In this regard, the hesitancy of the KFTC to weigh economic reports in cartel cases should be reconsidered. When there is direct evidence for cartel agreement, economic analysis is less likely to be informative. However, economic analysis is highly relevant in a cartel case where circumstantial factors are the key evidence available to prove the existence of a cartel. We hope that the KFTC will fully consider economic analysis when appropriate.

V. Competition Advocacy

Another area in which the KFTC has achieved significant success is competition promotion. First, the KFTC has repealed or modified numerous laws that officially sanctioned or encouraged cartel formation. For example, in 1999, the KFTC introduced the Omnibus Cartel Repeal Act, which abolished cartels in nine certified professions such as law.[30]

Second, a line of defense that is often advanced by cartel members is that the agreement was a direct or indirect outcome of "administrative guidance" by the ministries which oversee them. The KFTC has increasingly taken a hard line on such defenses. In late 2006, the KFTC issued a guideline that makes clear its stance that administrative guidance, without an explicit legal basis, cannot be a legitimate defense for collusive behavior.[31] In an important decision in August 2007, the Seoul High Court agreed with the KFTC in rejecting the incumbent telephone company KT's defense that its agreement on local telephone tariffs with the entrant Hanaro Telecom was dictated by the Ministry of Information and Communications.[32]

29 For example, the authors' review of the relevant material shows that the KFTC's evidence in the oil cartel case is scarce. KFTC Decision 2007-232, Concerning improper concerted acts by four oil refineries (Apr. 2007).

30 Omnibus Cartel Repeal Act, Law No. 5815 (Feb. 5, 1999), *available at* http://ftc.go.kr/data/hwp/G00013.doc (in English) (last visited Aug. 17, 2007).

31 The Korea Fair Trade Commission, Examination Guidelines for Improper Concerted Acts where Administrative Guidance Is Involved (Dec. 27, 2006) (in Korean).

32 KT v. KFTC, 2005 nu 20230 (Seoul High Ct. Aug. 2007). The court nonetheless vacated the KFTC's surcharge of 113 billion won on KT—the record surcharge on a single company in the KFTC's history—partly on the ground that the KFTC erred in finding that the collusion continued until August 2004, despite aggressive price cuts by Hanaro in April 2004. The first author of the current paper (Yi) submitted an economics expert paper (co-authored with others) to the Seoul High Court on behalf of KT which, among other things, examined when the cartel ceased to function.

Third, a unique feature of the Korean Competition Law gives the KFTC the power to promote regulatory reform. Article 63 of the MRFTA expressly requires other government agencies to consult with the KFTC on proposed laws or regulations that might restrain competition in order to minimize any adverse competitive effects. Other countries that try to develop competition law could learn from the Korean experience and institutionalize a similar requirement.

VI. Chaebol Regulation

Our most significant proposal to further the continuing modernization of Korean competition law concerns chaebol regulation. The dominance of chaebol over the Korean economy, in particular their debt-financed growth before the economic crisis in 1998, has compelled the Korean government to introduce extraordinary regulations not seen (or needed) in other countries. The KFTC has been at the forefront of chaebol regulation, and was given the legal authority to impose stringent ex ante limits on cross-shareholdings among chaebol affiliates, on levels of debt, and on debt guarantees to affiliates that chaebol could assume. The overarching goal of these measures was to limit the (sometimes reckless) expansion of the chaebol.

Such stringent ex ante regulations (for example, restricting the total amount of equity holdings of a chaebol affiliate to a percentage of its net capital in order to limit the expansion of the chaebol) can be justified only if there are serious market failures. We believe that the Korean economy before the economic crisis of 1998 indeed suffered from such a serious market failure in that the families that controlled the chaebol did not bear the full social cost of their debt-financed expansion.

As we discussed in Section II, under the policy environment characterized by the too-big-to-fail syndrome, the expansion-first strategy that many chaebol adopted before the economic crisis of 1998 was a rational decision for the families who controlled them, but imposed huge negative externalities on the Korean economy. As such, ex ante regulations on chaebol expansion could be justified to some extent.

However, the economic crisis of 1998 led to fundamental changes in the Korean economy. Fifteen of the top thirty chaebol in 1997 have since gone bankrupt, including Daewoo, then the fourth-largest chaebol in terms of total assets. Along with these bankrupt chaebol, the too-big-to-fail syndrome has largely disappeared as well. The chaebol that have survived the economic crisis have done so only after going through very painful restructuring processes. As a result, the surviving chaebol have emerged stronger than before.

The changes at Samsung Group, currently the largest chaebol in Korea, illustrate the sea changes that have taken place for the surviving chaebol in terms of debt ratios and profitability. Figure 1 shows that while the total assets of Samsung Group

Figure 1

Changes in Samsung Group's financial health after the 1998 economic crisis

	Total Assets (Trillion Won)	Total Equity (Trillion Won)	Total Debt (Trillion Won)	Debt-Equity Ratio
1997	50.7	13.8	36.9	267.2%
2005	100.4	67.0	33.4	49.9%
Difference	+49.7	+53.2	-3.5	-217.3%

Source: Sang-Seung Yi, A New Paradigm for Chaebol Regulation: Strengthening Competition Law Enforcement and the Introduction of "A Special Law on the Protection of Small Shareholders of Large Business Groups" (2006) (in Korean).

have nearly doubled from 1997 to 2005 (from 51 trillion won to 100 trillion won), total debt has actually decreased (from 37 trillion won to 33 trillion won), bringing down the debt-equity ratios from over 250 percent to below 50 percent.

The demise of the too-big-to-fail syndrome, the fundamental changes in how chaebol run their businesses (from a "growth first" strategy to a more balanced one and with proper attention paid to profitability of their investments), and the resulting huge improvements in profits and debt-equity ratios of surviving chaebol, call for fundamental rethinking of chaebol regulation. We propose that the KFTC abandon the vague and ill-defined concept of "concentration of economic power" and abolish ex ante regulations on cross-shareholdings, holding companies, and debt-equity ratios, because the Korean economy no longer suffers from the severe market failures associated with the debt-financed expansion of chaebol. In the place of these ex ante, one-size-fits-all regulations, we make two proposals.

We propose that the KFTC abandon the vague and ill-defined concept of "concentration of economic power" and abolish ex ante regulations on cross-shareholdings, holding companies, and debt-equity ratios, because the Korean economy no longer suffers from the severe market failures associated with the debt-financed expansion of chaebol.

First, the KFTC should strengthen the application of traditional competition law—cartels, mergers, and abuse of market dominance—to chaebol, with special attention paid to the unique situation that Korea is in due to the dominance of the chaebol. For example, economic research has shown that multi-market contact among firms facilitates collusion.[33] Top chaebol operate tens of affiliate companies that compete with other chaebol affiliates in many different markets, from consumer electronics to heavy machinery to insurance. Such multi-market contact creates a ripe environment for collusive behavior, which calls for close scrutiny by the competition authority.

Second, the fact that Korea no longer suffers from serious market failures resulting from the chaebol's expansion does not mean that the chaebol does not create policy problems. To the contrary, the chaebol present unique issues that have not been addressed in other industrialized countries. In our opinion, the heart of the remaining chaebol problem concerns the potential appropriation of the wealth of small shareholders by the controlling minority shareholders.[34] For example, controlling shareholders can set up a new affiliate in which they have high stakes and engage in business transactions with other affiliates on terms favorable to the new affiliate.

More generally, the intricate web of cross-shareholdings among chaebol affiliates allows the controlling family (which only hold a minority share) to exercise voting rights far in excess of their cash-flow rights, thereby seriously marginalizing other small shareholders and potentially allowing the controlling minority shareholders to engage in transactions that enrich themselves at the expense of other shareholders. These so-called "tunneling" problems are at the heart of corporate governance in Korea. The KFTC currently regulates such transactions as "undue subsidization of affiliates" and also tries to prevent them by putting ex ante limits on the total amount of equity investments of a chaebol affiliate or on the minimum equity that a holding company should maintain in its subsidiaries.

There are two problems with the current approach. First, we strongly doubt that such ex ante limits on equity holdings can provide any meaningful solution to the potential tunneling problems. Second, one can question whether the KFTC is the proper institution to regulate the corporate governance structure of chaebol.[35] It is our assessment that the various legal tools at the KFTC's disposal

33 Douglas Bernheim & Michael Whinston, *Multimarket Contact and Collusive Behavior*, 21(1) RAND J. ECON. 1-26 (Spring 1990).

34 Since the controlling families of a chaebol are typically minority shareholders themselves we therefore call them "controlling minority shareholders." We refer to other minority shareholders as "small" shareholders in order to make a distinction between the two.

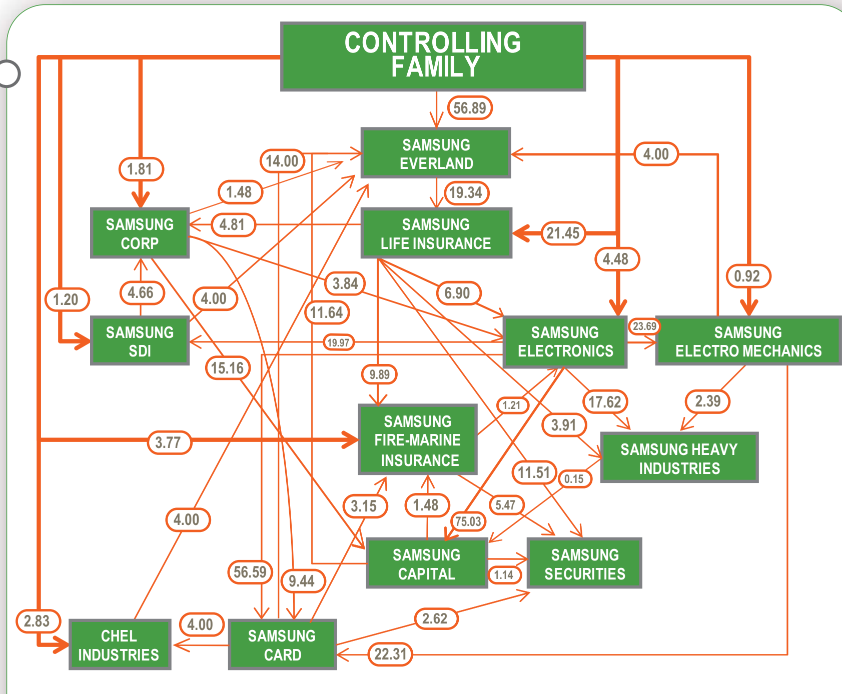
35 In addition to imposing ex ante regulations on the total amount of equity investments of a chaebol affiliate and on the minimum equity that a holding company should maintain in its subsidiaries, Chapter 3 of the MRFTA also contains provisions on disclosures to enhance transparency and on separation of the so-called "industrial" capital from the "financial" capital. The question arises whether the KFTC is a proper institution to administer these regulations. Although there are unique issues that do not squarely fit into other laws, as a matter of policy, these issues would be better overseen by other relevant laws, lifting the burden from the KFTC of this non-competition related undertaking. *See* Youngjin Jung, *Korean Competition Law: Policies and Development*, *in* COMPETITION LAW TODAY 364 (Vinod Dhall ed., 2007).

for chaebol regulation are not optimally tailored to address the issue of marginalization of minority shareholders. At a fundamental level, since these regulations pertain to the protection of shareholders, they are not the traditional prerogatives of a competition authority.[36]

We propose that these regulations intended to protect small shareholders of chaebol be spun off from the MRFTA and reenacted as a separate law or a separate chapter of the Korean company law with the clear mandate to protect small shareholders from the abuse of power by the controlling minority shareholders of chaebol. The starting point of our proposal is the analysis of chaebol from a corporate law perspective. In essence, a chaebol can be viewed as a group of de facto mutual joint holding companies. A very complex pattern of cross-shareholding exists among chaebol affiliates. Figure 2, for example, illustrates the cross-shareholding structure of some key companies of Samsung Group. While a traditional holding company holds 100 percent of equity of a subsidiary, chaebol affiliates indirectly hold equities of one another through circular investments (hence,

Figure 2

A spider web of cross shareholdings among key affiliates of Samsung Group



Source: Sonku Kim, Keunkwan Ryu, Sang-Seung Yi, & Kibeom Bin, Towards Market-Oriented Chaebol Policy (2003). Reprinted with permission from The Center for Corporate Competitiveness, Seoul National University.

36 Of course, if these inter-affiliate transactions have anticompetitive effects, they should be subject to competition law. However, current regulations do not even attempt to define relevant markets, let alone investigate whether there are likely or actual anticompetitive effects before condemning them.

they mutually serve as holding companies for one another)[37] and jointly hold equities of other affiliates (hence, they jointly serve as holding companies over other affiliates).[38]

Such complex cross-shareholdings raise difficult issues regarding the protection of small shareholders of a chaebol firm, who are, in effect, small shareholders of affiliate companies in which the chaebol holds equities directly or indirectly. In the United States, legal doctrines emerged to allow small shareholders of a holding company to file double derivative actions against the violation of fiduciary duties by directors of subsidiary companies. Currently, Korea lacks any legal provision for a double derivative suit even for a typical parent-subsidiary company structure, where one "parent" company holds all or most of shares of a subsidiary company. A recent attempt to allow a double derivative suit for such a typical parent-subsidiary relationship (with over 50 percent equity holding) failed due to opposition by chaebol. We believe that the uniqueness of the Korean situation calls for a much stronger measure because, as illustrated in the case of Samsung, a typical double derivative suit does not cover the vast majority of chaebol affiliates.

Hence, a key clause of a new law,[39] or a separate chapter of the company law for the purpose of protection of minority shareholders of large business group, would allow double derivative suits for shareholders of a chaebol company with regard to the actions of non-public (and hence, not subject to much market scrutiny) affiliates in which it holds non-negligible equity (e.g., one percent). Shareholders would also be given other rights such as the right to inspect the chaebol's accounting data in order to prevent tunneling problems (i.e., the exploitation of small shareholders by controlling minority shareholders of chaebol).[40]

37 Direct cross-shareholdings are prohibited among affiliates of chaebol with total assets over two trillion won.

38 For details, *see* Sonku Kim, Keunkwan Ryu, Sang-Seung Yi, & Kibeom Bin, Towards Market-Oriented Chaebol Policy, Powerpoint presentation (2003) (in English) (*based on* SONKU KIM, KEUNKWAN RYU, SANG-SEUNG YI, & KIBEOM BIN, DESIRABLE DIRECTIONS FOR REVISING THE CEILING ON TOTAL EQUITY INVESTMENTS (2003) (in Korean)). KIM ET AL. (2003) was commissioned by the Ministry of Finance and Economy and submitted in 2003 to the Taskforce on the Vision for Market Reform organized by the Korea Fair Trade Commission. The first author of the current paper (Yi) was a member of that taskforce.

39 The title that we propose is "A Special Law on the Protection of Small Shareholders of Large Business Groups." This new law would begin with the definition of a large business group, as Article 2.2 of the current MRFTA does. Its main provision would be to allow double derivative suits as we explain in the main text. The provisions in the MRFTA intended to protect small shareholders of chaebol (such as Article 11-2 on the disclosure of business transactions among chaebol affiliates) should be moved from the MRFTA to the new law.

40 For details regarding this and other proposals on how to fundamentally overhaul chaebol regulation, *see* SANG-SEUNG YI, A NEW PARADIGM FOR CHAEBOL REGULATION: STRENGTHENING COMPETITION LAW ENFORCEMENT AND THE INTRODUCTION OF "A SPECIAL LAW ON THE PROTECTION OF SMALL SHAREHOLDERS OF LARGE BUSINESS GROUPS" (2006) (in Korean).

We note that the KFTC has recently been moving in the direction of easing ex ante regulations on chaebol. We also note that there is a sharp division of opinions among Korean intellectuals about how to reform chaebol regulation. For example, the first author of the current article (Yi) is of the view that the proposals suggested above should be implemented promptly because the current regulations do not provide any meaningful solution to the tunneling problems, whereas the second author (Jung) takes the view that the KFTC should gradually curtail its role as the chaebol regulator but should relinquish it only when the market mechanism can sufficiently discipline the tunneling problems.

VII. Mergers

The KFTC's track record on merger enforcement (at least until recently) is not something that a competition authority should be proud of. Indeed, in its own evaluation of its first 20 years, the KFTC candidly admitted that it had not been very active in the merger enforcement area.[41] Until very recently, the KFTC rarely banned mergers or imposed structural remedies such as divestitures.[42] Rather, its remedies were typically price controls[43] or sometimes, market share restrictions.[44] It goes without saying that these remedies run counter to the core principles of competition law.

The KFTC seems to be well aware that it needs to strengthen its merger enforcement regime. Indeed, there are encouraging signs that the KFTC is increasingly favoring structural remedies when feasible. For example, it recently banned two mergers, Muhak-Daesun, a 2003 merger attempt between two local soju (Korean hard liquor) companies, and Samik-Youngchang, a 2004 merger between two piano manufacturers, and ordered divestitures in several mergers (e.g., Hyundai Hysco-INI Steel, a 2004 merger between two steel companies, and DC Chemical-Columbian Chemicals, a 2006 merger between two chemical companies).

41 Korea Fair Trade Commission (2001), *supra* note 8.

42 For example, between 1981 and 2000, there were over 5,500 mergers, out of which the KFTC has banned only three, all of which were in rather small markets. *See id*. at 261-69.

43 For example, in a 1999 merger between Hyundai Automobile and (then-bankrupt) Kia Automobile, their combined shares in truck market were close to 95 percent. The KFTC allowed the merger on the condition that the combined firm not raise domestic prices higher rates than export prices. KFTC Decision 99-43, Concerning violation by Hyundai Automobile of article on combination of enterprises (Apr. 1999).

44 In a 2000 merger between SK Telecom and Shinshegi Telecom, whose combined markets shares were 57 percent, the KFTC ordered that the combined firm reduce its market share to under 50 percent by June 2001. KFTC Decision 2000-76, Concerning violation by SK Telecom of article on combination of enterprises (May 2000).

The KFTC has also accepted the use of economic analysis in defining the relevant market and identifying anticompetitive effects. For example, its first enforcement in a non-horizontal, non-vertical merger case (Hite-Jinro, a 2006 merger between the largest beer company and the largest soju company) was based on the economic theory that they shared the same distribution channel and could engage in anticompetitive tying.[45]

One remarkable development is that the Korean courts preceded the KFTC in accepting some aspects of economic analysis. Specifically, in the 2004 *Muhak/Daesun* decision, the Seoul High Court applied the critical loss analysis based on the hypothetical monopolist test as a proper mechanism to define the relevant geographical market.[46] In its 2006 decision in *Hite/Jinro*, the KFTC followed suit and also used critical loss analysis to define the relevant geographical market. The KFTC is also currently revising its Merger Guidelines, including the possibility of replacing the C3 (the three-firm concentration ratio) with HHI (the Herfindahl-Hirschman Index that captures the pattern of concentration in a richer way than the C3 does) as a measure of concentration.[47]

For competition law and economics with regard to mergers, Korea raises two interesting and difficult challenges. First, many Korean firms operate both in the Korean market and in markets overseas. It is rarely the case that the merger between two Korean firms (or a Korean firm and a multinational firm that operates in Korea) creates competitive concerns in foreign markets, but it does so often in Korea. Frequently the merger is driven by the desire to realize economies of scale or scope to compete more effectively in overseas markets. The domestic Korean market is relatively small in size. In a standard approach, the competition authority would define two (or several) relevant geographical markets and weigh anticompetitive effects against efficiencies in each market.[48] Under this approach, in the foreign market the merger would be deemed to create few, if any anticompetitive concerns, but some efficiency gains. In the Korean market, however, the merger would create anticompetitive concerns, but the efficiency gains that the firms assert that they would gain in the overseas market do not directly translate into savings that can be passed through to domestic consumers.

45 The first author of the current paper (Yi) submitted an economic analysis paper that advanced this theory. (The second author of the current paper (Jung) represented Jinro.) Even though the KFTC accepted this theory, the remedy it imposed was weak, in that it simply ordered the combined company not to discriminate against other firms over distribution channels. KFTC Decision 2006-009, Concerning violation by Hite Beer of article on combination of enterprises (Jan. 2006).

46 Muhak v. KFTC, 2003 nu 2252 (Seoul High Ct. Oct. 2004). The first author of the current paper (Yi) submitted an economic analysis paper on behalf of Muhak, with a focus on the geographical market definition.

47 In fact, the KFTC staff routinely use HHI as a supplementary tool for measuring concentration.

48 This is the case unless the market is found to be worldwide.

In such a situation, the standard approach would call for divestiture in Korea that would preserve the competitiveness of the Korean market at the pre-merger level. But that could jeopardize the merger itself, depriving the companies of the opportunity to realize efficiencies in the foreign markets.[49] Such a scenario raises an interesting research (and policy) issue—whether it might be appropriate for a competition authority to use the total social welfare standard over all geographical markets combined (which recognizes fixed-cost savings and other gains in the foreign markets as efficiencies, and weighs them against anticompetitive effects in the domestic market) as opposed to the narrow consumer welfare standard in each geographical market concerned (which does not). That is, the Korean experience suggests that an export-oriented economy could consider the total social welfare standard over all geographical markets combined (which considers gains in the foreign markets as legitimate efficiencies to be weighed against anticompetitive losses in the domestic market) as the proper welfare standard in evaluating mergers.

Second, the dominance of chaebol over the Korean economy raises novel and difficult issues with regard to merger enforcement. Chaebol routinely acquire firms as a means of expanding into new businesses. Such conglomerate mergers do not raise anticompetitive concerns that arise in horizontal or vertical mergers. An interesting research topic would be to examine whether the moribund conglomerate merger doctrine could be resurrected in the Korean context. Of course, we are not advocating that the KFTC ban new conglomerate mergers or try to disband existing chaebol without sound economic theory and empirical demonstrations of anticompetitive harm. Nonetheless, it would be interesting to see if it is possible to formulate a coherent and sound antitrust doctrine regarding why and how conglomerate mergers might be anticompetitive, while recognizing the potential efficiency gains from such mergers.

VIII. Abuse of Market Dominance

As is the case with mergers, the KFTC's enforcement record on abuse of market dominance under Article 3-2 of MRFTA has been sparse at best. Instead, the KFTC has relied on the unfair trade practices provision (Article 23) of the MRFTA when the appearance of abuse of a dominant position in the market has arisen. This meager enforcement of the abuse of market dominance provision of

49 These issues surfaced in the aforementioned DC Chemical-Columbian Chemicals merger, where a Korean chemical company (DC Chemical) tried to acquire a global company (Columbian Chemicals) with operations in nine countries. The KFTC took issue with only the Korean market and ordered DC Chemical to sell one of its two Korean factories as a condition for acquiring Columbian Chemicals, over the DC Chemical's protest that doing so would deprive it of the economies of scale/scope from the merger, which were needed to compete with top multinational firms in the global market. The first author of the current paper (Yi) served as the economics expert witness for DC Chemical. The case is currently pending at the Seoul High Court. KFTC Decision 2006-173, Concerning violation by Columbian Chemicals Acquisition LLC of article on combination of enterprises (Aug. 2006)

the MRFTA has been rightly criticized, especially considering Korea's prevailing monopolistic market structure stemming from the longstanding legacy of past industrial policy. The disproportionate enforcement record on unfair trade practices has impeded sound development of a traditional area of competition law and policy.

THE DISPROPORTIONATE ENFORCEMENT RECORD ON UNFAIR TRADE PRACTICES HAS IMPEDED SOUND DEVELOPMENT OF A TRADITIONAL AREA OF COMPETITION LAW AND POLICY.

Article 23 of the MRFTA regulates unfair trade practices.[50] The provision was modeled after a similar provision in the Japanese Antimonopoly Law, which was, in turn, based on Section 5 of the U.S. Federal Trade Commission Act.[51] Article 23 of the MRFTA does not necessarily regulate trade practices that negatively affect competition. Rather, it regulates a broad range of unfair trade practices that are "likely to compromise fair transaction," which is different from "substantial diminution of competition" as set forth under cartel or merger regulations. Therefore, Article 23 regulates not only practices that would affect competition, such as refusal to deal, discrimination, and tying, but also practices that have to do with so-called unfairness of methods or the abuse of dominant position in contracting with other enterprises, which arguably do not create anticompetitive effects in the market. The comprehensiveness of Article 23, and administrative convenience, has made the regulation regarding unfair trade practices the key legal instrument for regulating various anticompetitive behaviors in Korea and has minimized the role of the abuse of market dominance provision.

In recent years, however, the KFTC has tried to aggressively apply the abuse of dominance provision (Article 3-2) in some selected areas. The first major case in which the KFTC applied Article 3-2 was its 2001 decision on refusal to deal. The KFTC ruled that the dominant steel company POSCO's decision not to supply hot coils to Hyundai Hysco violated the MRFTA. However, the KFTC's decision did not involve any extensive economic analysis of whether POSCO's refusal to deal actually restricted competition in the market.[52]

50 MRFTA, *supra* note 1, at art 23 ("Prohibition of Unfair Business Practices").

51 U.S. Federal Trade Commission Act, 15 U.S.C. § 45 (2006).

52 KFTC Decision 2001-068, Concerning Abuse of Market Dominant Position by POSCO (Apr. 2001). This decision is only ten pages long. In 2002, the Seoul High Court upheld the KFTC's decision, but did not conduct any proper economic analysis either. POSCO v. KFTC, 2001 nu 5307 (Seoul High Ct. Aug. 2002). In 2003, at the request of a study group at the Supreme Court, the first author of the current paper (Yi) wrote an economics analysis paper on this case. He argued that POSCO's refusal to deal did not create any significant anticompetitive effects, because Hysco could easily turn to Japanese steel producers (which it did) and operated at maximum capacity. For details, *see* Sang-Seung Yi, An Economic Analysis on the Refusal to Supply by POSCO (2003) (in Korean). At the time of the writing of the current article, the case is still pending at the Supreme Court.

One problem is that the KFTC's enforcement has been somewhat selective. In particular, the KFTC opted not to bring an enforcement action against a group boycott in May 2005 by the four broadcasting companies (which collectively accounted for over 90 percent of all broadcasting content in Korea) to withhold their content from TU Media, a satellite digital media broadcasting (DMB) service provider. The broadcasting companies were competing with TU Media to set up their own terrestrial DMB services. The group boycott appeared to be a naked refusal to deal without any pro-competitive or efficiency justifications and clear anticompetitive effects. Hence, it is puzzling that the KFTC has taken no action against it, but has taken action against a unilateral refusal to deal that did not have clear anticompetitive effects.

In the so-called new economy sector, however, the KFTC has been truly aggressive—indeed arguably more aggressive than any other competition authority in the world. In early 2006, after more than four years of investigation, the KFTC ruled that Microsoft had abused its dominant market position by tying its Windows Media Player (WMP) and Windows Messenger to its Windows PC operating system, and tying Windows Media Services to its Windows Server operating system.[53]

This landmark case involved many firsts for the KFTC. In April 2004, one month after the European Commission issued a similar decision against Microsoft's inclusion of Windows Media Player in the Windows PC operating system, the KFTC formed a three-member taskforce to expedite its investigation. While the case was originally initiated by Daum (a Korean portal site operator that featured its own instant messenger) in late 2001 with the release of Windows XP, after the KFTC expanded its investigation to cover digital media in 2004, U.S.-based Real Networks filed its own complaint before the KFTC.

In addition, the KFTC expanded due process quite significantly, giving Microsoft significant opportunities to review the Examiner's original evidence under its revised guideline on case handling and holding a total of seven hearings to conduct proper deliberation.[54]

Third, the KFTC proudly announced that it was the first competition agency in the world to address the tying of messenger programs and media servers. (The European Commission only addressed media players.) The KFTC's remedy on media players and messengers went beyond the Commission's. While the Commission only ordered Microsoft to release a version of Windows without

53 *Microsoft*, *supra* note 17.

54 In the *Microsoft* case, however, while Microsoft was given significant access to the Examiner's original evidence and chances to rebut it, it was not given any chance to review or rebut the Examiner's additional evidence (collected after Microsoft's rebuttal papers were submitted) or Real Networks' evidence before the KFTC made its decision. Its February 2006 decision cited these pieces of evidence, but Microsoft was not able to challenge them until after the KFTC decision was issued.

WMP (along with a full version), the KFTC additionally required Microsoft to include an icon on the program menu of the full version of Windows for "Media Players/Messenger Centers" with download links to competing media players and messengers if Microsoft provided the full version.

The KFTC's decision in the *Microsoft* case has received a mixed review. While the European Commission expressed its strong support for the KFTC,[55] the Antitrust Division of the U.S. Department of Justice released a formal statement criticizing it as "ultimately harm[ing] innovation."[56] It remains to be seen how the Seoul High Court will sort out many of these complex legal, economic, and technical issues. The legal issues include whether Korean competition law requires a positive price for the tied good, as we discussed previously.[57] The key economic issue in the *Microsoft* case is whether Microsoft's integration of features forecloses competition. Microsoft emphasizes that the Internet is a highly efficient distribution mechanism for media players and messengers. This is particularly true in Korea, which led the world in broadband penetration from 2000 to 2006. Microsoft also points out that Korean media players and messengers are now the leading software programs in the Korean market, supplanting Microsoft's media player and messenger software. The KFTC responds that this fact alone does not prove that competition is not foreclosed and alleges that network effects magnify the anticompetitiveness of the media player/messenger tie. It remains to be seen how the Seoul High Court will evaluate these conflicting claims.

As expected, the *Microsoft* decision has propelled the KFTC into a major player in global antitrust enforcement. International companies have begun to take a closer look at the KFTC's enforcement policy. Following *Microsoft*, the KFTC

55 At the June 2006 annual meeting between the European Commission and the KFTC, Commissioner Neelie Kroes remarked to the reporters: "In the Microsoft case, KFTC sent a very strong signal that Korea will never be a safe haven for those who abuse dominant position. KFTC should be praised for that." (The first author of the current article (Yi) served as a discussant for Commissioner Kroes' speech on the European Commission's Discussion Paper on Article 82.)

56 J. Bruce McDonald, Statement of Deputy Assistant Attorney General J. Bruce McDonald Regarding Korean Fair Trade Commission's Decision in its Microsoft Case (Dec. 7, 2005), *available at* http://www.usdoj.gov/atr/public/press_releases/2005/213562.htm.

57 The relevant provision on unfair trade practices regarding illegal tying explicitly uses the word "purchase." In contrast, the provision on abuse of market dominance does not explicitly use the word "purchase." Therefore, to the extent that the provision on unfair trade practices applies, the "purchase' requirement appears to be at odds with the competition laws of the European Community and United States. The other equally thorny issue is that the provisions set forth under Article 3-2 of MRFTA do not squarely fit the definition of illegal tying. The KFTC found the applicable provision in "an act unfairly or unreasonably coercing a transaction or behavior that is disadvantageous to the transacting partner" which is a type of behavior that is enumerated in the Notification on Abuse of Market Dominance. This statutory Notification states that such act is "an act that unfairly or unreasonably hampers business of other enterprises" under Article 3-2 of MRFTA and its corresponding Presidential Decree. In addition, the KFTC also subsumed Microsoft's tying practices as "the act that is likely to appreciably diminish the interests of consumers" as set forth under Article 3-2. Microsoft challenges the legitimacy of the KFTC's interpretations. It remains to be seen how the reviewing court will decide on these issues.

commenced investigations into alleged abusive behavior by Intel and Qualcomm. In early September 2007, the KFTC sent an Examination Report (the rough equivalent of the European Commission's Statement of Objections) to Intel for alleged exclusionary abuses of its dominant market position. If the full Commission affirms the charges contained in the Examination Report, this case will be marked as another strong indication of the KFTC's aggressive enforcement against alleged abuses of market dominance.

The KFTC has also taken a more aggressive stance against alleged abuse of market dominance by major Korean companies. For instance, in 2007 the KFTC ruled that SK Telecom, the largest mobile carrier in Korea, restricted consumer choice and competition by adopting a digital rights management (DRM) software which is not interoperable with competing software.[58] In addition, the KFTC found Hyundai Motors, the largest automaker in Korea, liable for various acts that hampered business of its distributors.[59]

The KFTC's increasingly aggressive enforcement activities with regard to abuse of market dominance raise thorny issues. A worrisome trend of the KFTC is that it interprets the provision on abuse of market dominance (Article 3-2) in a manner that is similar to its interpretation of the prohibition against unfair trade practices (Article 23). Arguably, the KFTC concentrates on behavioral irregularities rather than on detailed market analysis to discern illegal acts that adversely affect the relevant market. Ascertaining the behavioral irregularities is only the first step in evaluating the legitimacy of the alleged abusive act by the dominant company. The KFTC frequently refers to "an act that unfairly or unreasonably hampers business of other enterprises" under Article 3-2 of the MRFTA and its related provisions stipulated in the Notification on Abuse of Market Dominance.[60] For example, in the *Microsoft* and *SK Telecom* cases, the KFTC predicated the statutory basis of its enforcement upon this provision. The KFTC has yet to utilize rigorous market analysis in its evaluations, instead of focusing on behavioral irregularities.

IX. Enforcement

A. PRIVATE ENFORCEMENT

As explained above, the KFTC is entrusted with the primary responsibility for enforcing Korean competition law. Private parties rarely bring suit against

58 KFTC Case Decision No. 2007-044, Concerning abuse of market dominant positions, etc. by SK Telecom (Feb. 2007)

59 KFTC Case Decision No. 2007-281, Concerning abuse of market dominant positions, etc. by Hyundai Automobile (May 2007).

60 Korea Fair Trade Commission, Examination Guidelines for Abuse of Market Dominant Positions (Jun. 2006) (in Korean).

antitrust lawbreakers. Since antitrust violations essentially relate to tort law, in a broad sense, private parties could file a suit based on general tort liability provisions under the Korean Civil Code. However, in the absence of extensive U.S.-style discovery, it is often prohibitively difficult for the plaintiff to show the basic elements such as intent, negligence, or causality required for a typical damages claim under the Korean Civil Code. For this reason, the number of damages suits based on antitrust violations has been dismally low, if not non-existent.

We propose two changes to the MRFTA in order to facilitate private enforcement actions. First, the law should allow class action lawsuits to recover damages. Given concerns about excessive litigation, Korea could begin with a high threshold for the standing requirement or allow private class actions only after the KFTC has found liability. Second, private parties should be allowed to file lawsuits to enjoin suspected competition law violations. To the extent practicably possible, the scope of the current document production order under Korea's Civil Procedure Act should be expanded to aid private plaintiffs. We examine these two issues in more detail in the following paragraphs.

Prior to the 2004 amendment, the MFRTA contained a special provision that provided for strict liability in damages suits in connection with antitrust violations. However, plaintiffs could invoke this provision only after the KFTC's corrective measures with regard to the antitrust violation at hand had been finalized. Therefore, a plaintiff had to rely on general tort causes of action under the Korean Civil Code to bring suit prior to the finality of the KFTC's corrective measure. As a result, one could argue that private antitrust damages actions were disfavored in Korea.

The 2004 amendment aimed to encourage private damages litigation. The amendment abolished the requirement that the KFTC's corrective measure must be finalized if a plaintiff wishes to bring suit for antitrust damages under the MRFTA. However, it allowed the defendant to invoke a defense that no intent or negligence exists with respect to the alleged wrongdoings. Prior to this amendment, the defendant was subject to strict liability, which did not allow the defendant to invoke any defense in the civil damages court proceedings. Furthermore, the amendment introduced a provision that alleviates the plaintiff's burden of showing the amount of damages that arise out of the antitrust violation. The provision stipulates that if it is extremely difficult to prove the necessary facts to verify the precise amounts of damages, then the court shall estimate damages based on the result of evidentiary investigation and the intent of overall pleadings.[61] Given that it is always a challenge to ascertain the precise amount of damages arising out of an antitrust violation, this provision is a welcome change.

However, private damages actions are still not actively filed in Korea. Punitive damages and treble damages are not available to successful plaintiffs, class actions

61 MRFTA, *supra* note 1, at art. 57 ("Limitations on Claims for Damages and Related Matters").

are not allowed, and discovery is very limited. We believe that these measures should be introduced in order to further facilitate private damage suits, especially against hard-core cartels. For example, Korea could begin by allowing class actions against hard-core cartels after liability is established by the KFTC. Currently, end-user consumers have little incentive to file damages suits even if the KFTC finds liability and the courts affirm it.

Turning to private suits for injunctive relief, it is unfortunate that the MRFTA has no provision for such actions. In the *Microsoft* case, Daum filed an action for injunction in late 2001 against the introduction of the Windows XP operating system (and filed a complaint with the KFTC as well). But a Korean court dismissed the lawsuit in 2003, largely on the grounds that the MRFTA has no provision allowing private parties to bring suits for injunction in antitrust cases.[62] We strongly urge the KFTC to amend the MRFTA to allow private suits for injunction against suspected competition law violations. The KFTC needs to practice what it preaches and introduce competition in competition law enforcement.

THE KFTC NEEDS TO PRACTICE WHAT IT PREACHES AND INTRODUCE COMPETITION IN COMPETITION LAW ENFORCEMENT.

All in all, despite the latest legislative effort to encourage private antitrust enforcement, we are unlikely to see robust private enforcement of Korean competition law in the near future without more sweeping legislative reforms such as the introduction of U.S.-style discovery rules. However, introducing such discovery rules would present a significant challenge to the Korean judicial system. Following the tradition of the European civil law system, Korean judges are entrusted with the primary responsibility for gathering evidence, which is a stark contrast to U.S. civil procedure.

As of now, class actions only take place in Korea in a limited form in securities cases. There is a fear in the business community that class actions will lead to the development of a more litigious society that will, in turn, raise costs for businesses. The plethora of private litigation is not always well-regarded even in the United States. For instance, Judge Posner of the U.S. Court of Appeals for the Seventh Circuit warns that private litigation is a stumbling block to sound development of antitrust law and policy.[63] In the absence of a U.S.-style jury system, Judge Posner's concern might be alleviated because, in Korea, professional judges take the place of laymen juries and may be better able to screen out frivolous and unfounded private litigations.[64] We believe that the benefits from

62 Daum v. Microsoft, 2001 gahap 60373 (Seoul Central Dist. Ct. Aug. 2003).

63 RICHARD A. POSNER, ANTITRUST LAW 275 (2nd ed. 2001) ("The influence of the private action on the development of antitrust doctrine has been on the whole a pernicious one.").

64 It is true that summary judgment is a safeguard against frivolous lawsuits in the United States, but oftentimes the judges simply refer the matters to jury trial.

expanding private litigation clearly outweigh any potential costs, and thus call for a revision of the MRFTA to facilitate private antitrust suits.

B. CRIMINAL ENFORCEMENT

In recent years, criminal enforcement against Korean members of hard-core cartels has become tougher. Earlier this year, a Korean court handed down a prison sentence (sentenced for one year and suspended for two years) for cartel participants for the first time. Korean executives have also been subject to criminal enforcement by foreign authorities such as the U.S. Department of Justice.[65] Because no other sanction is more effective in deterring participation in cartels than criminal sanctions against the individuals involved, we welcome these tougher punishments.

We also believe that the KFTC should be given stronger enforcement tools against hard-core cartels under close cooperation with the Prosecutor's Office. Because the Prosecutor's Office may not prosecute antitrust violators without a referral from the KFTC, the Prosecutor's Office has so far played a minimal role in enforcing Korean competition law. In the past, the KFTC rarely referred the matter to the Prosecutor's Office, even in cases involving cartels. The Prosecutor's Office frequently took issue with the KFTC's dominance in enforcement of Korean competition law. Indeed, the Prosecutor's Office has recently displayed a strong interest in preserving its prosecutorial authority and has created some tension between itself and the KFTC.

A significant source of the recent tension is the success of the leniency program. Under current guidelines, the KFTC used to not refer leniency applicants to the Prosecutor's Office except in special circumstances. This means the Prosecutor's Office is effectively barred from exercising its prosecutorial discretion and authority. Earlier this year, the KFTC and the Prosecutor's Office reportedly reached an understanding that the KFTC should refer to the Prosecutor's Office the third and subsequent filers. As a result, the KFTC started to refer an increasing number of cartel cases to Prosecutor's Office.[66]

An important issue in criminal enforcement against hard-core cartels concerns the KFTC's investigative power. Currently, it lacks compulsory investigative

65 For example, in 2006 Korean executives of the U.S. subsidiaries of Samsung Electronics and Hynix Semiconductor received prison sentences ranging from five to eight months in the DRAM collusion case. Press Release, U.S. Department of Justice, Samsung Executive Agrees to Plead Guilty, Serve Jail Time for Participating In DRAM Price-Fixing Conspiracy (Sep. 21, 2006), *available at* http://www.usdoj.gov/atr/public/press_releases/2006/218462.htm.

66 So far, the Prosecutor's Office has not exercised its criminal investigative power to the fullest extent. However, in a case involving collusion on apartment prices by construction companies, a local Prosecutor's Office initiated a criminal investigation on its own initiative and arrested several employees of the companies concerned. This case is notable because the KFTC investigated the case and decided not to refer the matter to the Prosecutor's Office while levying an administrative surcharge.

power such as search and seizure. Instead, KFTC investigations rely on voluntary cooperation from the alleged wrongdoers. The penalty for disobeying the KFTC's request for cooperation is not particularly burdensome. The maximum financial penalty for non-compliance is approximately US$100,000 to US$200,000 for the company and US$10,000 to US$50,000 for an individual depending on the reasons for non-compliance.

As the KFTC's enforcement intensifies, frequently there is increased friction between the investigators and the alleged wrongdoers under investigation. Nevertheless, it is rare that those under investigation persist in failing to cooperate with the investigation. This is the case because the enterprises under investigation often fear that failing to cooperate likely invites heavier penalties after the investigation is completed. Therefore, enterprises usually cooperate voluntarily with the KFTC's investigations.

Having said that, however, it becomes more complicated when the KFTC carries out an on-the-spot investigation at the premises of an enterprise under investigation. The investigators are frequently challenged (though not met with physical resistance) by the companies concerned regarding the extent to which the KFTC can review and seize emails and documents under the MRFTA. The KFTC's recent attempt to acquire stronger investigative tools, such as the power to seal the evidence at the site of the investigation target, failed in the National Assembly due to objections from the Prosecutor's Office. We urge the KFTC and the Prosecutor's Office to sit down and find a mutually agreeable compromise.

Currently the KFTC's expansive investigative power for enforcing chaebol regulations (especially its power to demand sensitive data from financial institutions regarding inter-affiliate transactions) is under heavy criticism from the business community. These concerns have led the business community to oppose increasing the KFTC's investigative power in any area, including hard-core cartel enforcement. However, given the pervasive collusive culture among Korean businesses, we believe that the KFTC should be given proper investigative tools in close cooperation with the Prosecutor's Office. Armed with compulsory process the KFTC would be able to more effectively gather the evidence necessary to prove collusive behaviors. Turning *voluntary* investigative power into *compulsory* investigative power, at least with respect to cartel investigation, also has the benefit of placing the KFTC's investigation under appropriate judicial control.

X. Problematic Amalgamation of Investigation and Adjudication

One of the key problems with the KFTC's current structure is that the agency is responsible for both investigation and adjudication. The KFTC has an investigative arm called the Secretary General's Office. Among the various responsibilities of this office, the Secretary General takes the responsibility of overseeing all investigations. Once the Examiners who report to the Secretary General finish their investigations into alleged antitrust violations, they prepare Examination Reports (a rough equivalent of the European Commission's Statement of Objections). The Secretary General then refers the Examination Report to the KFTC, which is composed of five standing Commissioners (including a Chairman and Vice-Chairman) and four non-standing Commissioners. One of three standing Commissioners who is neither Chairman nor Vice-Chairman assumes the primary responsibility of reviewing any given case. Commissioners, especially each of the above three standing Commissioners, are assisted by the Office of the General Counsel.

While the formal structure of the KFTC that we have described might suggest that the Secretary General's Office and the General Counsel's Office are run independently, in practice, the separation of investigation from adjudication is blurred. Occasionally one hears complaints that the examiner charged with the investigation in any given case routinely contacts the General Counsel's Office ex parte and, in some cases, may also have such contact with the responsible Commissioner. Since the Commission's adjudication process is given the status of a court of first instance, the whole process of the Commission should ensure that the defendant receives due process rights for asserting and maintaining its defense. The adjudication process should be as impartial as possible and the Examiners should be just another party as are the defendants.

Unfortunately, the KFTC's long-standing personnel policy, stemming from its days as an arm of the (now-defunct) Economic Planning Board, does not maintain a separation between employees of the Secretary General's Office and those in the Office of the General Counsel. They are constantly rotating between offices without any distinction. Hierarchy governs not only within the Secretary General's Office, but also between the Secretary General's Office and the General Counsel's Office.

The KFTC is aware of this problem and has been considering the establishment of an independent professional adjudicator's office, similar to the office of Administrative Law Judge in the United States or the Hearing Officer in Japan. The benefit of introducing an independent adjudicator is not only that it establishes independence from the influence of the Secretary General, but also makes possible an overhaul of the hearing process by applying more rigorous evidentiary rules that modify the court process to reflect the nature of administrative process. We welcome the KFTC's efforts in this area, but urge it to move much faster to implement such reforms and find suitable institutional mechanisms to accelerate the transformation of the KFTC into a fully functioning, quasi-judicial body.

XI. Conclusion

For a young agency with only a quarter-century history, the KFTC has achieved some remarkable success in cartel enforcement and the promotion of competition. However, its track records in enforcing merger control and abuse of dominance leave much to be desired. While its recent attempts to embrace economic analysis and ensure due process are certainly laudable, the KFTC needs to accelerate its efforts to transform itself so as to become a leading agency in global antitrust enforcement. In particular, it needs to relinquish its near monopoly over competition law enforcement and to fundamentally rethink its regulation of chaebol.

Ultimately, it is up to the Korean courts as well as the KFTC as to whether or not Korea succeeds in making another leap forward in competition law enforcement. We are encouraged by the ability of Korean judges to digest complex economic analysis, as exemplified by the recent decisions on collusion damages and market definition. An increase in private litigations will provide the court with more opportunities to fashion jurisprudence to which the KFTC should look for guidance. Unless they are subject to review by the courts, competition agencies will also pursue their own agendas and cling to power over law enforcement. Of course, we are mindful that judges trained as generalists could show huge variations in their ability to grasp complex economic issues and render sensible decisions. Nevertheless, it should be the job of competition authorities, practitioners, and economists to explain, in plain language, the complex economic issues so that judges can come to reasonable decisions.

Ultimately, it is up to the Korean courts as well as the KFTC as to whether or not Korea succeeds in making another leap forward in competition law enforcement.

In other words, competition law agencies should be exposed to competition, as they advocate and indeed, mandate, in other areas. In order to achieve its aspiration to be recognized as a leading force in global antitrust—for which it has already made significant progress—the KFTC should embrace competition and allow private parties to seek injunctions of anticompetitive behavior, strengthen its economic analysis unit, fundamentally overhaul its chaebol regulation, establish a "Chinese wall" between its investigative and adjudicative offices and personnel, and increase its efforts to guarantee proper procedural rights to competition law defendants. In taking these steps, the KFTC can grow from its current new kid on the block status to a leader in global antitrust.

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The Antimonopoly Law in China: Where Do We Stand?

Xinzhu Zhang and Vanessa Yanhua Zhang

The recent development of China's Antimonopoly Law has caught the attention of governments, academia, and businesses. Although China has laws that address anticompetitive conduct and institutions to enforce them, they are disparate and do not constitute a comprehensive competition regime. Recent antitrust cases in China have stressed the need for a competition law that can be applied consistently across sectors. In this paper, the authors explain China's legislative process, the relationships among its relevant institutions, and explore the problems and challenges facing lawmakers. Although the 2007 passage of the Antimonopoly Law was an important step towards a comprehensive competition regime, it remains to be seen how it will operate in practice when it goes into effect on August 1, 2008. The authors argue that two key issues remain unresolved: 1) how the Antimonopoly Law will be backed by an effective enforcement process; and 2) how the Antimonopoly Law will effectively deal with administrative monopolies.

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I. Introduction

Since the late 1970's, China has been undergoing a successful transition from a centralized to a market-oriented economy. A series of reforms has increased the privatization of farmlands, which in turn has increased the responsibility of local industry managers and the number of small-enterprises. Over the course of the last twenty-five years, China's gross domestic product (GDP) has grown at an average annual rate of 9.4 percent and, as of 2006, was the fourth largest in the world behind the United States, Japan, and Germany.[1] Foreign direct investment has also increased, and is currently estimated at over US$70 billion in 2006.[2]

Despite its increasingly prominent role in the global economy, China has never had a comprehensive competition law to protect the fruits of its market-driven economic reform. Initial steps towards a comprehensive competition law were taken in 1993 when a board of experts was elected to develop a preliminary version of an antimonopoly law. Various other laws to address competition issues followed. However, the real impetus for establishing a comprehensive competition law struck in 2001 when China joined the World Trade Organization (WTO) and the National People's Congress (NPC) Standing Committee agreed that China would adopt a comprehensive competition law to comply with WTO requirements.

Since then, developing an antimonopoly law has remained one of the Chinese government's top priorities. Several iterations of a draft antimonopoly law have been released, reviewed, and scrutinized, and have kindled ardent disputes in academia. The NPC, Ministry of Commerce (MOFCOM), the State Administration of Industry and Commerce (SAIC), and China's State Council have hosted numerous conferences and meetings with domestic and international experts and officials to encourage input and gather feedback on the law. The revisions continued until August 30, 2007, when a final version of the Antimonopoly Law [hereinafter "AML"][3] was passed by the twenty-ninth session of the tenth NPC. The AML will become effective on August 1, 2008.

Throughout the deliberation process, particularly during the final stages between 2004 and 2007, two key issues emerged. The first issue was with regards to enforcement structure. Prior to the AML, a number of institutions bore responsibility for upholding aspects of China's existing competition laws. Deciding how, and especially, by whom, the AML should be enforced going forward posed a challenge. The second issue concerned administrative monopoly and how to regulate certain government agencies and local governments that restrict competition.

1 World Bank, World Development Indicators Database (release as of Jul. 1, 2007).

2 Press Release, United Nations, Foreign Direct Investment Roes by 34% in 2006 (Sep. 1, 2007), *available at* http://www.unctad.org/Templates/Webflyer.asp?docID=7993&intItemID=2068&lang=1.

3 Several drafts of the AML were issued throughout the review process. In this article, AML refers to the final Antimonopoly Law that was passed on August 30, 2007 and will be effective August 1, 2008. The People's Republic of China, Antimonopoly Law (Aug. 30, 2007) (in Chinese) [hereinafter AML].

The final AML still does not clearly address either issue and the State Council is expected to provide further clarifications this year before the AML takes effect.

In this paper, we focus on these two remaining elements of the AML. The paper is structured as follows: Section II explains the current institutions and litigation process of the AML; Section III cites recent antitrust cases in China which have attracted considerable interest from commentators; Section IV explores the Law's most significant potential weaknesses; and Section V concludes.

II. Current Institutions and Litigation Process

The existing rules and institutions that govern anticompetitive behavior are haphazard and form neither a consistent nor comprehensive system of competition law, as demonstrated by recent cases. Despite this, the existing framework has played a key role in the development of the AML. China has always adopted a gradual approach to reform, which means that the current rules and institutions have greatly impacted the AML's structure and enforcement.

THE EXISTING FRAMEWORK HAS PLAYED A KEY ROLE IN THE DEVELOPMENT OF THE AML. CHINA HAS ALWAYS ADOPTED A GRADUAL APPROACH TO REFORM, WHICH MEANS THAT THE CURRENT RULES AND INSTITUTIONS HAVE GREATLY IMPACTED THE AML'S STRUCTURE AND ENFORCEMENT.

A. THE EXISTING ANTITRUST RULES

China's competition policy is governed by a number of specific laws, administrative rules, and regulations in addition to the recently passed AML. The first law that deals with competition policy is the Anti-Unfair Competition Law enacted in 1993.[4] While this law mainly functions as a consumer protection law, it also contains some antitrust rules such as Article 12, which prohibits tie-in sales, and Article 15, which prohibits price-fixing and bid-rigging.[5] The second antitrust law is the

4 PEOPLE'S REPUBLIC OF CHINA, ANTI-UNFAIR COMPETITION LAW (Dec. 1, 1993) (in English), *available at* http://en.chinacourt.org/public/detail.php?id=3306. The structuring of competition laws into the Anti-Unfair Competition Law and the Antimonopoly Law created some confusion over the principle goals of the laws. The title "Antimonopoly" has lead to debates that concentrate on the monopoly status or market power itself, rather than the anticompetitive conduct of the monopoly (or dominant firm). Antitrust law is concerned with the latter.

5 *See* ANTI-UNFAIR COMPETITION LAW, *supra* note 4, at art. 12:

> Manager shall not sell commodity attached with unreasonable condition or force the consumers to unwillingly purchase any additional commodity that come together with the product that the consumer buys.

Also see, *ibid.* at art. 15:

> Bidder shall not act in collusion for bidding, not raise or reduce the price for bidding.
>
> Bidder shall not collude with the company that is offering to bid in order to put the other bidders out of the competition.

Price Law enacted in 1997, which contains provisions against improper pricing behaviors including price-fixing, predatory pricing, and price discrimination.[6]

In addition to these two laws dealing with antitrust issues, there are some important administrative rules and regulations that deal with antitrust policy. For instance, the rule, Prohibiting Public Utility Companies from Restricting Competition, was issued by the SAIC in 1993 and contains antitrust rules for public utility sectors.[7] The regulation policy, Rules on Prohibiting Regional Blockade in Market Economic Activities, was issued by the State Council in 2001 and deals with administrative monopoly.[8] One important rule which deals mainly with abuse of market power is the 2003 Provisional Rules on Prevention of Monopoly Pricing (the Provisional Rules) issued by the National Development and Reform Commission (NDRC).[9] It prohibits market dominance (inferring dominance from market shares of relevant markets), promotes substitutability of relevant goods and services, and encourages free entry. It also prohibits price coordination, supply restriction, bid-rigging, vertical price restraint, and below-cost pricing as an abuse of dominance.

With regards to merger and acquisition control, an important rule is the 2003 Provisional Rules on Acquisitions of Domestic Enterprises by Foreign Investors (the Merger and Acquisition Rules) issued by MOFCOM and revised in 2006 based on the Provisional Rules.[10] On March 8, 2007, MOFCOM issued the *Guidelines for the Antitrust Filing for Merger and Acquisition of Domestic Enterprises by Foreign Investors* (the Filing Guidelines),[11] which replaces an earlier version from April 20, 2006 (the Original Guidelines). In fact, the Filing Guidelines summarize several provisional rules and regulatory policies. The purpose of the

6 PEOPLE'S REPUBLIC OF CHINA, THE PRICE LAW (Dec. 29, 1997) (in English), at art. 14, *available at* http://en.chinacourt.org/public/detail.php?id=99.

7 PEOPLE'S REPUBLIC OF CHINA, PROHIBITING PUBLIC UTILITY COMPANIES FROM RESTRICTING COMPETITION (Dec. 24, 1993) (in Chinese), *available at* http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300027927.html.

8 PEOPLE'S REPUBLIC OF CHINA, RULES ON PROHIBITING REGIONAL BLOCKADE IN MARKET ECONOMIC ACTIVITIES (Apr. 21, 2001) (in Chinese), *available at* http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300027985.html and http://www.lawinfochina.com/law/display.asp?db=1&id=1820 (in English).

9 PEOPLE'S REPUBLIC OF CHINA, PROVISIONAL RULES ON PREVENTION OF MONOPOLY PRICING (Jun. 18, 2003) (in Chinese), *available at* http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300028008.html.

10 PEOPLE'S REPUBLIC OF CHINA, PROVISIONAL RULES ON ACQUISITIONS OF DOMESTIC ENTERPRISES BY FOREIGN INVESTORS (Mar. 13, 2003) (in Chinese), *available at* http://tfs.mofcom.gov.cn/aarticle/date/i/s/200509/20050900366385.html (revised Aug. 10, 2006, *available at* http://www.xasmw.com/rule/content.asp?id=254 (in Chinese)).

11 PEOPLE'S REPUBLIC OF CHINA, GUIDELINES FOR THE ANTITRUST FILING FOR MERGER AND ACQUISITION OF DOMESTIC ENTERPRISES BY FOREIGN INVESTORS (Apr. 2007) (in Chinese), *available at* http://tfs.mofcom.gov.cn/aarticle/bb/200704/20070404597464.html.

Filing Guidelines is to present a roadmap for parties to understand when and what to file when they need a merger or acquisition approved by MOFCOM.

B. CURRENT ENFORCEMENT

According to the Constitution of the People's Republic of China, the State Council is the highest organ of state power and state administration in the executive branch. In the legislative branch, the National People's Congress (NPC) is considered to be at the head of the hierarchy. The NPC is partially composed of a permanent body called the Standing Committee of the National People's Congress. The NPC and its Standing Committee have enacted a huge amount of legislation on topics of all description. These laws have been supplemented by myriad regulations of the State Council, and the central ministries and commissions under it, as well as provincial and local people's congresses and governments.

1. Government Agencies

Until recently, China's competition policy relied mainly on administrative government enforcement. This is understandable given that China is still in a transition from a centrally planned economy to a market-driven economy and that the administrative system is more established than the court system.

The main feature of the current antitrust enforcement regime is a multi-principal structure, under which three agencies share responsibility for enforcing China's current antitrust rules. The first agency responsible for enforcing China's current antitrust rules is SAIC, as authorized by the Anti-Unfair Competition Law. SAIC is primarily in charge of the micromanagement of market activities, ranging from business and trademark registration to street market regulation. SAIC has branches in virtually every major city in China. At the central government level, SAIC has a Fair Trade Bureau that contains an antimonopoly division. SAIC used to be a deputy-level administration, but it was promoted to ministry-level in 2005 in an attempt to enhance its enforcement authority. The change of administrative hierarchy was very important in China where administrative power is traditionally considered more important than the power of the legal authorities.

The second main antitrust enforcement agency is NDRC, which has specific authority to enforce the Provision Rules, but also has general authority to enforce the Price Law. In some sectors, NDRC serves both as the regulator and as the competition policy enforcement agency.

The third antitrust enforcement agency in China is MOFCOM as authorized by the Merger and Acquisition Rules. In 1998, MOFCOM was restructured by combining the former Ministry of Foreign Economic and Trade, the Ministry of Domestic Commerce, and some departments of the State Economic and Trade Commission. The State Economic and Trade Commission was the first institution commissioned to draft an antimonopoly law, so MOFCOM, together with

SAIC, was naturally authorized by the State Council to draft the AML. MOFCOM is also responsible for antitrust review of merger and acquisitions, in particular foreign acquisitions of domestic companies.

Government agencies are not the only ones enforcing competition law in China. In many sectors, the regulator is also the de facto antitrust enforcement agency. For instance, according to the 2000 Regulations on Telecommunications of People's Republic of China, the Ministry of Information Industry (MII) also has the authority to deal with competition policy issues in the telecom sector.[12]

Until recently, SAIC and MOFCOM were the two most active and prominent government agencies enforcing antitrust rules.[13] SAIC released the influential 2004 report, *Multinational Companies' Competition Restricting Behavior and Counter Measures*,[14] while MOFCOM's achievements included creating the Antimonopoly Investigation Office. Many speculated that these two institutions saw themselves as the leading candidates to house the new antimonopoly enforcement agency when the law was enacted. While the State Council commissioned them to jointly draft an antimonopoly law, both ended up submitting their own version when they were unable to reach an agreement regarding enforcement agencies.

2. The Court System

In China, the courts are divided into Courts of General Jurisdiction and Courts of Special Jurisdiction.[15] Under the Courts of General Jurisdiction is the Supreme People's Court and the Local People's Courts. The latter includes three courts responsible for issues at the provincial level:

1. the basic people's court which is the lowest local courts and court of first instance;
2. the intermediate people's court which acts as the court of first instance for important local cases and appeals court for cases from the basic people's court); and
3. the high people's court which is the highest local court and reports to the people's congresses at provincial level.

12 People's Republic of China, Regulations on Telecommunications of People's Republic of China (Sep. 25, 2000) (in Chinese and English), *available at* http://law.chinalawinfo.com/newlaw2002/SLC/slc.asp?db=chl&gid=31476.

13 As a government agency, NDRC is special in that it is an administrative superpower.

14 The State Administration of Industry and Commerce, Report on Multinational Companies' Competition Restricting Behavior and Counter Measures (Mar. 2004).

15 In accordance with the Constitution of the People's Republic of China and the Organic Law of the People's Courts.

The Supreme People's Court handles national matters and is the highest court in the judicial system in China. The Courts of Special Jurisdiction comprise the Military Court of China, Railway Transport Court of China and Maritime Court of China.

The court system is paralleled by a hierarchy of prosecuting organs called People's Procuratorates. The Supreme People's Procuratorate resides at the highest level of this structure. The Supreme People's Court and the Supreme People's Procuracy are both very active, although they are subordinate to the NPC. They also have issued large numbers of "interpretations" (the substantive equivalent of supplementary legislation) and other documents, either separately, with each other, or with other agencies.

The trial process is an important part of adjudication and is greatly influenced by the civil law jurisdiction in which the judge is the dominant party in trial procedures. According to law, each case shall have at most two trials, which means that litigants to a case and their legal representatives who challenge the judgments made by a local court in the trial of first instance have the right to appeal the case to the next higher level court only once. Once the appeal is filed, the next higher court must try the case again. Normally, the judgment of the second trial is final and cannot be appealed. However, the parties to litigation may challenge the final decision or the effective decision through the trial supervision procedure. They may appeal to the appellate court or the higher court. After reviewing the complaint, the president of the court may ask the judicial committee to make a decision to accept or reject the appeal. Under no circumstances does the re-trial initiated by trial supervision procedure suspend the enforcement of the effective judgment that is challenged.

The AML does not address how antitrust cases, specifically, should be dealt with under the existing court system. One question that remains is whether private litigation can serve as a deterrent of antitrust offenses given the current structure of the judicial system.

III. Recent Antitrust Cases in China

Although the existing laws and institutions have provided some protection against anticompetitive behavior, recent cases involving antitrust issues illustrate the need for further reform to ensure that competition law is applied in a consistent and comprehensive manner.

A. CASE 1: SICHUAN TSUM POWER COMPANY V. SONY[16]

In November 2004, Sichuan TSUM Power Company (Sichuan TSUM) filed a landmark antitrust case against Sony and Shanghai Suoguang Electronics (Sony)

16 Sichuan TSUM Power Company v. Sony Corp. (filed in the People's No. 1 Intermediate Court, Shanghai) (Nov. 2004) (not yet reported).

in response to Sony's decision to manufacture its digital video products entirely in China. Sichuan TSUM was a local high-tech company that provided research and development, production, and sale and after-sale service of various batteries for digital cameras and video cameras. Sichuan TSUM batteries could be used in several brand's digital products, such as Panasonic and JVC, but could not be used in Sony's digital camcorders and cameras. When Sony made its manufacturing announcement in March 2004, market experts forecasted a rapid increase in Sony's share of the digital camera market as a result. Sichuan TSUM alleged that Sony was engaging in monopolization and abusing its dominant market position. It also claimed that Sony's use of an electronic coding feature in its digital cameras and video cameras violated China's competition laws since only Sony batteries could be used in these devices, qualifying as a bundle or tie-in sale.

The Shanghai People's No. 1 Intermediate Court heard the case. During the proceedings, even attorneys for the plaintiff noted that this case would be challenging to decide given that there was no formal antimonopoly law at that time. When this paper went to press, no verdict has been decided. Whether the AML will lessen the challenge of deciding cases like these greatly depends on how the State Council decides to enforce the Law in practice and what it determines the role of the courts to be.

Whether the AML will lessen the challenge of deciding cases like these greatly depends on how the State Council decides to enforce the Law in practice and what it determines the role of the courts to be.

B. CASE 2: US CARLYLE GROUP'S PURCHASE OF XUZHOU CONSTRUCTION MACHINERY[17]

In October 2005, US Carlyle Group became the first foreign firm to purchase a Chinese firm with its buyout of of Xuzhou Construction Machinery (XCM), China's biggest machinery engineering manufacturer. According to signed stock purchase and joint-venture agreements, the Carlyle Group would pay RMB 3 billion (US$375 million) to purchase an 85 percent stake in XCM, a subsidiary company of Xuzhou Construction Group (XCMG).

XCMG was a state-owned enterprise (SOE) under the supervision of the state-owned Assets Supervision and Administration Commission of the Xuzhou, Jiangsu province. It was also listed as one of the main SOEs that needed further reform or restructuring. XCMG, needing the gains that would result from restructuring which could serve to repay bank loans and restructure other poorly-performing subsidiaries, searched for a buyer for over two years. After several rounds of bidding, XCMG chose Carlyle, a highly profitable U.S.-based private

17 For details on the purchase, *see* Andrew Batson, *Carlyle to Buy Less of Chinese Firm*, Wall St. J., Mar. 19, 2007.

equity firm with strong political connections in Washington, DC.[18] The local government supervised the entire negotiation, from the restructuring plan to the sale price, to keep its state-owned capital from being undervalued.

Since Carlyle's total investment exceeded US$100 million, the project needed approval from NDRC and, given it involved a foreign stake, it also needed to undergo MOFCOM's approval process. MOFCOM was concerned about antitrust issues. It asked for an antitrust report from both XCMG and Carlyle to prove that the buyout would not create a monopoly and harm domestic firms. In October 2006, the plan was revised and Carlyle's stake was reduced to 50 percent. When the buyout was finally approved by MOFCOM in March 2007, Carlyle's stake had fallen to 45 percent or RMB 1.8 billion (US$225 million).

By limiting Carlyle's investment in XCMG, MOFCOM kept the state's holdings in XCMG above the 50 percent required for the enterprise to be classified as "state-owned". While MOFCOM may have expressed concerns about the antitrust issues the merger would create, it seems MOFCOM was also interested in maintaining the state's position as a majority stakeholder. Despite its role as an antitrust enforcer, MOFCOM acted more out of concern for state control than for competition. How such actions by administrative agencies should be addressed is one of the key issues undergoing review this year prior to the AML's implementation in August 1, 2008.

C. CASE 3: THE SUPOR (ZHEJIANG, CHINA) AND SEB (FRANCE) MERGER CASE[19]

The recent merger of Supor, the largest cookware manufacturer in China, with SEB, a France-based producer of small domestic appliances, raised more questions about how to define monopolization.

Supor, founded in 1988, is one of China's largest manufacturers of electrical kitchen appliances, with an annual production capacity that exceeds 3.5 million units. SEB, a global leader in domestic appliances, and the world's largest manufacturer of small appliances, sells its products in more than 120 countries. The company is famous for its Krups, Moulinex, Rowenta, and Tefal brands.

In August 2006, Supor agreed to sell a 61 percent stake in its operations to SEB in a three-stage transaction. As part of the deal, SEB would transfer technologies, management expertise, and more original equipment manufacturing and original design manufacturing projects to Supor. Both firms would share their sales and after-sales networks.

18 *See* Dan Briody, The Iron Triangle: Inside the Secret World of the Carlyle Group (2003).

19 For background on the merger, *see SEB given green light to acquire majority stake in China's Supor*, People's Daily Online, Apr. 12, 2007, *available at* http://english.peopledaily.com.cn/200704/12/eng20070412_365898.html.

Given Supor's leading position in China's cookware market (at the time it held a 47 percent market share), domestic competitors strongly objected to the transaction. In August 2006, soon after Supor announced the takeover agreement, six large cookware producers, including the second and third biggest cookware manufacturers, ASD and Double Happiness Co., respectively, urged MOFCOM to ban the merger, concerned that SEB would monopolize the Chinese market after taking control of Supor. MOFCOM carried out antitrust investigation in October 2006 and eventually approved the merger on April 11, 2007. MOFCOM did not explain why it approved the merger, and the combination provides another example that would have benefited from more clarity on the goals of merger regulation. We are hopeful that the newly enacted AML will provide an official and explicit guideline with regards to merger cases.

D. CASE 4: INTEL V. DONGJIN CO.[20]

Touted by the media as the leading intellectual property (IP) case in 2005, the *Intel* case evolved into China's leading antimonopoly case in 2006.

Dongjin Co. was founded in 1993 and was the first domestic company to conduct its own research and development of the core technology behind its computer technology integration (CTI). Dongjin was a large CTI provider in China, and at one point ranked third worldwide. In 2000, Intel acquired Dialogic (the largest CTI provider in China) for US$800 million and Dongjin and Intel became direct rivals.

In December 2004, Intel's headquarters in the United States filed a petition against Dongjin with the Middle People's Court in the Shenzhen province, claiming that Dongjin had infringed its software copyright. Intel estimated it was owed damages of US$7.96 million (RMB 65.78 million). Intel was quite confident that it would win its case given its supporting evidence and the current condition of IP protection in China. It also hoped that this case would send a message to other companies in China that might be infringing on its IP.

However, Dongjin did not respond directly to Intel's claims. Instead, in March 2005, Dougin's Beijing branch filed its own petition against Intel, claiming that Intel was exercising monopoly power by building technological barriers to block its competitors.

The case quickly attracted the attention of the media and public. Experts, scholars, and the public press, lacking an understanding of the details of the technology and litigation process, accused Intel of "entrapment" and criticized it for protecting of its technology monopoly.[21] Frustrated by the public pressure and

20 *See* Intel Corp. v. Dongjin Co. (filed in Middle People's Court, Shenzhen) (Dec. 2004) and Dongjin Co. v. Intel Corp (filed in the People's No. 1 Intermediate Court, Beijing) (Mar. 2005).

21 *See Dongjin and Intel: the Leverage Threat*, COMPETITION POWER, Jun. 2007 (in Chinese).

urged by the Court, Intel negotiated an out-of-court settlement with Dongjin. On May 14, 2007, Intel and Dongjin held a joint news briefing and announced their out-of-court settlement.[22] Given their lack of experience to deal with private litigation, courts in China prefer out-of-court settlement in most cases. The recent passage of the AML will likely put more pressure on China's court system to observe and learn from international experience.

The cases discussed in this paper reinforce the need for an effective antimonopoly law that is intent on protecting competition (rather than protecting SOEs) and that encourages foreign investment. The volume of mergers and acquisitions by foreign enterprises grew from US$1 billion in 1999 to US$31 billion in 2006.[23] As foreign interest in China grows, so does the need for clarity around China's competition laws. However, the State Council still has a number of issues left to address before the AML goes into effect.

IV. Challenges Facing the AML

Although the newly implemented AML could potentially provide a more effective and consistent competition law regime, it has left several questions unresolved. In this section, we will explore two main issues: enforcement and administrative monopoly.

A. ENFORCEMENT

Under the AML, a new enforcement authority (or "Antimonopoly Commission") is to be established to uphold it. There is concern, however, about whether the Commission will be able to effectively enforce the law given its structure and limited powers. According to the AML, the enforcement authority:

1) is independent and authoritative; and

2) has the power to take certain coercive measures and to impose punishments.

Despite these admirable principles, it is not clear that they will apply in practice. First, the structure of the reporting line is not made clear in the AML, which brings into question whether the enforcement authority will truly be independent. In the AML draft of June 2006, there was a clause that said that the Commission should be established "under the State Council [and] composed of the principals of relevant departments and organs of the State Council and cer-

22 *See Dongjin Settled IP Litigation, Intel Denied Competition Restriction*, Sina News, May 14, 2007 (in Chinese), *available at* http://tech.sina.com.cn/it/2007-05-14/12041505334.shtml.

23 *See Foreign Investment Status 2006 and 2007 Forecast*, Foreign Investment in China, May 2007 (in Chinese), *available at* http://www.ficmagazine.com/article.php?FicID=1264&Colum=%E4%B8%93%E5%AE%B6%E8%AE%BA%E5%9D%9B.

tain experts."[24] Under this arrangement, the inherent relationship between the assigned commissioners and the departments of the State Council they previously headed would have been maintained. But this clause was later deleted and in the final AML, the precise arrangement is not explained except to say that the State Council is responsible for developing the structure and protocol of the Commission and for ensuring that the commissioners remain fair and impartial in dealing with conflicts that with the relevant government departments in administrative monopoly cases. The State Council is also identified as the final decision maker, which automatically reduces the independence of the enforcement authority. Antitrust enforcement regularly conflicts with other government goals (e.g., merger control may be affected by government trade policies and industrial policies or control of monopolistic agreements may be affected by macroeconomic policies). This lack of complete independence represents an inherent weakness of the system.

In the final AML, the precise arrangement is not explained except to say that the State Council is responsible for developing the structure and protocol of the Commission and for ensuring that the commissioners remain fair and impartial in dealing with conflicts that with the relevant government departments in administrative monopoly cases.

Second, the AML dilutes the absolute authority of the Commission. As discussed earlier in this paper, MOFCOM, NDRC, SAIC and other regulators have all played a role in regulating anticompetitive conduct in the past. In their respective drafts of the AML submitted to the State Council, SAIC and MOFCOM each designated themselves as the future antitrust enforcement agency of the AML. The State Council conceded some of the power to the agencies by proposing a dual-layer enforcement structure. In the first draft of the AML submitted to the People's Congress in June 2006, the Council proposed the establishment of an Antimonopoly Commission consisting of high-level officials from different government agencies and reporting directly to the State Council. At the lower level, the draft also proposed that an antimonopoly enforcement agency (or agencies) be created to carry out the day-to-day enforcement activities. The final AML dropped this arrangement, however, and it is not clear how the agencies will be organized.

The AML also received complaints from other government agencies resistant to change. Establishing a new antimonopoly enforcement agency meant reducing the role of the agencies that up until then had been responsible for antitrust

24 *See* The People's Republic of China, Antimonopoly Law (draft of Jun. 2006) (in Chinese), at art. 32 ("Composition of the Anti-Monopoly Commission under the State Council"):

> The Anti-Monopoly Commission under the State Council is composed of the principals of relevant departments and organs of the State Council and certain experts. Its rules of procedures and work are stipulated by the State Council.

enforcement and regulatory supervision. In response, the State Council made further concessions. Under the AML, monopolistic activities, which are within the scope of regulatory agencies' investigative power according to other laws and administrative regulations, are still to be investigated by those regulatory agencies.[25] While the agencies are required to report their enforcement results to the Commission, the Commission itself investigates monopolistic activities only when they are not being investigated by the regulatory agencies.

From a political standpoint, these concessions did facilitate early passage of the AML, but they are likely to lead to disagreements. Provisions in several industry laws and regulations, such as the Natural Gas Law, the Telecommunication Rules, and the Anti-Unfair Competition Law, grant overlapping enforcement power and increase conflict among the different law enforcement authorities. According to the litigation process of the AML, the three possible enforcement authorities are MOFCOM, NDRC, and SAIC. The AML does not provide clear guidance on how to allocate responsibilities among the enforcement authorities. Nor does it specify how the Commission should work with these other enforcement authorities. These concessions have resulted in a failure of the AML to address one of the major reasons for replacing China's fragmented antitrust laws in the first place: The need for a uniform enforcement agency that would enforce the law in a consistent and predictable manner.

So what alternatives are left to lawmakers? Private litigation is often discussed as an enforcement alternative to the regulatory agencies. Under the antitrust enforcement process in China, there are two channels by which a private party may pursue litigation. One is called administrative re-evaluation or administrative litigation.[26] This occurs when a party is not satisfied with the verdict of a

25 Article 7 of the AML is ambiguous about the authority of enforcement of antitrust rule in the concerned areas. As a legal matter, to get rid of the ambiguity and the tension between the AML and the existing division of authorities, the antimonopoly rules in other laws and regulations may have to be taken away and then the responsibilities re-authorized based on the AML. *See* AML, *supra* note 3, at art. 7:

> Industries controlled by the State-owned economy and relied upon by the national economy and national security or industries implementing exclusive operation and sales in accordance with the law shall be protected by the State to conduct lawful operation by the undertakings. The State shall supervise and control the price of commodities and services provided by these undertakings and the operation of these undertakings so as to protect the interests of the consumer and facilitate technical progress.
>
> The undertakings mentioned in the paragraph above shall operate, in good faith, in accordance with the law and in a self-disciplined manner, accepting public supervision and shall not harm the interests of the consumer from a controlling or exclusive dealing position.

26 *See, e.g.*, *id.* at art. 53:

> Where the undertakings and interested parties are dissatisfied with the decisions made by the Anti-Monopoly Law Enforcement Authority, they may apply for administrative reconsideration; if they do not agree with the result of the administrative review, can initiate administrative litigations in accordance with law.

public enforcement process. The private party can go to the court to sue the enforcement agency and ask for a reinvestigation of the case. This mechanism opens the possibility for private action. China's legal system, however, is well-known for the difficulties that face private parties that sue the government. Therefore, the effectiveness of this mechanism for private enforcement of antitrust rules is weak.

Another possibility for private litigation is for private parties to bring a civil suit to court directly. There are two instruments for private enforcement: stopping infringement and damage liabilities. The AML states that entities that exercise monopolistic conduct will be civilly liable if damages are incurred by other parties.[27] Article 50 of the AML provides the legal foundation for an entity to be civilly liable for its monopolistic conduct. But, it is too simple to clarify either the civil responsibilities that should be taken or the implications of AML on damage liabilities. This may result in damage liabilities in antitrust cases being imputed based on the principles and rules of damage liabilities under tort. However, damage liability rules under antitrust cannot be simply interpreted as civil damages. Rather, they are an important part of the private enforcement mechanism of antitrust. In the United States, for instance, private action civil suits are an important mechanism for enforcing antitrust rules. There is a treble-damage provision that provides a strong incentive for private parties, including group litigation, to sue and provides an effective deterrent to monopolistic conduct.[28] Without a proper incentive mechanism under the AML,[29] damage liabilities based solely on civil damages will not provide a sufficiently strong deterrent against infringement. Therefore, private litigation cannot play an important role in antitrust enforcement.

B. ADMINISTRATIVE MONOPOLY

Another key concern of the AML is the extent to which it addresses administrative monopoly. Administrative monopoly refers to the actions of government and its subordinate agencies that abuse administrative power in order to promote, manipulate, or impede economic activities that restrict competition. Administrative monopoly does not necessarily refer to SOEs, but certain SOEs do benefit from administrative monopoly given their fiscal contribution. Administrative monopoly is classified into two categories: local protection and

27 *See id.* at art. 50:

> Where the undertakings implement Monopolistic Conducts and cause loss to others, the undertakings shall be responsible for the civil liabilities in accordance with the laws.

28 The European Community used to rely mainly on public litigation. Recently, it has made some reforms to emphasize the role of private litigation.

29 Of course, it has been debated that the special damage liability requirement has provided incentives to initiate suits.

sectoral protection. The former is easy to understand literally, and the latter refers to the protection of certain, often public sector, industries (e.g. energy, transportation, and telecommunication). Administrative monopoly is also a natural consequence of China's years as a centrally planned economy.

There are several ways administrative monopolies can abuse their power:

1) Regional blockade. Local government may refuse to issue licenses to enterprises that trade commodities originating in other regions;

2) Restriction on market access. Local governments may discriminate against non-local undertakings by restricting or rejecting investment or the establishment of branches by undertakings in other regions;

3) Designated deals. Government and its subordinate agencies may require undertakings to purchase, use, or deal with the products supplied by designated undertakings;

4) Forced restrictions on competition. Administrative authorities may compel undertakings to pursue monopolistic conduct that is prohibited by antitrust laws; and

5) Prohibited conducts. Government and its subordinate agencies may set regulatory rules that eliminate or restrict competition.

The supply of petrol provides a high-profile example of an administrative monopoly. In 1999, various State Council departments issued a document prohibiting any company except for SinoChem and PetroChina from selling wholesale petrol products. In 2001, they issued another document prohibiting the retail sale of petrol product by any company other than SinoChem and PetroChina.[30] Similar practices can be found in many other industries including the energy, infrastructure, utilities, and transportation sectors. The abuse of administrative power contributes greatly to the serious corruption problems in China.[31]

The potential for consumer harm is a strong argument for placing the conduct of administrative monopolies firmly within the ambit of the AML. Despite this, it is not clear that it would be in the interests of either the Chinese government or local governments to take a hard line against administrative monopolies. Local governments are financially dependent on tax income from local branches of SOEs such as infrastructure, energy, utilities, and transportation. Therefore, the prohibition of administrative monopoly has its inherent conflicts with local

30 Xia Ying, *Antimonopoly: Reality and Expectation*, South China Weekend, Jul. 29, 2004.

31 There is a lot of confusion regarding the definition and the scope of administrative monopoly. First, the object of administrative monopoly is government rather than corporations. Second, administrative monopoly is not the same as regulation of a natural monopoly or other government-championed industries. Indeed, the AML excludes legal franchising from antitrust review (*see* AML, *supra* note 3, at art. 7). However, undue government regulations are deemed administrative monopolistic conduct.

government interests. Using the AML to break-up administrative monopolies would, in effect, place restrictions on the regulatory power of certain arms of government. Consequently, some officials and governmental departments may oppose and try to impede implementation of the AML.

Furthermore, it is not clear that the enforcement bodies will have the power to apply the AML to administrative monopolies. According to the Chinese administrative law, only a government department that resides at a level higher in the bureaucratic system has the administrative authority to supervise the behavior of those at the lower levels. Since administrative monopolies are created by government departments, an antimonopoly agency would need the power to overrule these departments when dealing with administrative monopolies when they arise. But under the framework of the AML, the Commission lacks such authority. Indeed, according to Article 51 of the AML,[32] when dealing with government agencies at a higher level, the antimonopoly agencies can only suggest remedies. Therefore, the Commission's ability to deal effectively with administrative monopolies depends on how the State Council establishes its responsibilities in relation to the other enforcement authorities, and in particular, its relative rank, which will decide its influence on other government departments.

THE COMMISSION'S ABILITY TO DEAL EFFECTIVELY WITH ADMINISTRATIVE MONOPOLIES DEPENDS ON HOW THE STATE COUNCIL ESTABLISHES ITS RESPONSIBILITIES IN RELATION TO THE OTHER ENFORCEMENT AUTHORITIES, AND IN PARTICULAR, ITS RELATIVE RANK, WHICH WILL DECIDE ITS INFLUENCE ON OTHER GOVERNMENT DEPARTMENTS.

The limitations imposed by Article 51 inhibit the antimonopoly agency's ability to apply the AML to administrative monopolies. This contrasts with the trend in other jurisdictions, where competition authorities are increasingly given powers to overturn actions of the state which infringe competition rules. In the European Community, for instance, the European Commission can prohibit anticompetitive practices by SOEs. It can also prohibit anticompetitive state aid and take action against acts by the Member States that infringe on competition rules under Articles 86 and 87 of the EC Treaty. In Russia, any acts, actions, or agreements of the federal or state governments that harm competition are prohibited under their antimonopoly law while administrative monopoly is covered by the authority of the Russian

32 *See* AML, *supra* note 3, at art. 51:

> Where administrative organs and public organizations abuse administrative powers, performing activities which exclude and restrict competition, the superior entity shall order them to revoke and modify the act; where the circumstances are serious, the entity of the same level or in the superior level shall impose administrative penalty on the chief officer directly responsible for it in accordance with the laws. Where there is other stipulation in laws and administrative regulations concerning the disposal of activities excluding or restricting competition by administrative organs and public organizations' abusing administrative powers, the other stipulations shall apply.

antimonopoly agency.[33] In Hungary, the Competition Office also has jurisdiction over competition-restricting activities of the government.[34] The latter two examples show that economic transition from a centrally-planned to a market-orientated economy is no reason to allow administrative monopoly to escape the jurisdiction of the AML.

V. Conclusion

The development of a market-oriented economy in China has created a need for a modern antitrust law. Although over the past decade laws and institutions have developed to address competition issues, recent antitrust cases in China illustrate the urgent need for a consistent and comprehensive application of competition law. The final AML is a significant improvement on the disparate laws and institutions that went before it, and is poised to act as an economic constitution in the Chinese economy.

However, doubts still remain over the overall effectiveness of the AML. It is not clear how well the AML will be enforced. Furthermore, it is unclear how anticompetitive conduct by administrative monopolies will be dealt with under the AML. The current design may lead to disagreements among the designated agencies, and fail to ensure that competition policy is applied in a consistent and comprehensive manner. The possibility of deterrence through private litigation also appears weak.

The AML is a significant step forward for competition law in China. But it seems unlikely that this single step will, on its own, provide China with the effective and consistent competition law regime it is currently lacking. If China chooses not to address some of the key issues still facing the AML, then the uncertainty and ambiguity of the current regulatory environment may dampen the economic growth it has so far enjoyed.

33 Organisation for Economic Co-operation and Development, *Competition Law and Policy in Russia*, An OECD Peer Review (2004), at 35.

34 Organisation for Economic Co-operation and Development, Hungary: Report on Competition Law and Institutions (2004), at 16-17.

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Consumer Surplus as the Appropriate Standard for Antitrust Enforcement

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Consumer Surplus as the Appropriate Standard for Antitrust Enforcement

Russell Pittman

In antitrust enforcement, in the context of cost-benefit analysis, neoclassical economics may be interpreted as arguing for the use of a total welfare standard whose implementation treats transfers as welfare-neutral. Several recent papers call for antitrust agencies to move in the direction of this version of a total welfare standard for enforcement. However, as Oliver Williamson noted in his 1968 paper, horizontal mergers typically result in transfers that may greatly exceed in magnitude any deadweight loss or efficiency gain, so that a decision to ignore transfers may be quite important. In this paper, I argue that such transfers are likely overall to be quite regressive, and thus that a consumer surplus standard rather than a total welfare standard may be appropriate for antitrust. Two common arguments against this standard—that most mergers are in markets for intermediate goods, and that a consumer welfare standard implies a tolerance for monopsony—are examined and found wanting. I argue in addition that, even if a total welfare standard is used, both the finance literature on merger outcomes and the structure of the U.S. enforcement agencies suggest that the use of a consumer surplus standard by the agencies is more likely to achieve that goal.

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I. Introduction

The discussion of the proper welfare standard for antitrust enforcement—with a focus on merger analysis—continues. The *Horizontal Merger Guidelines* of the U.S. agencies spell out an enforcement standard that is arguably close to a consumer surplus standard, focusing on the effect of a merger on the prices paid by customers and emphasizing the desirability of efficiencies that lower marginal costs and thus are likely to have a direct impact on post-merger prices.[1] However, recent papers by Ken Heyer and Dennis Carlton argue forcefully for the orthodox standard of neoclassical economics, total welfare: consumer surplus plus producer surplus, with transfers canceling each other out.[2] Ross and Winter also argue for total surplus, but at least in part because they believe that accounting for transfers by adding additional weight to changes in consumer surplus would generally not change things much—assuming that the weight chosen is appropriate.[3]

On the other hand, other recent papers—for example, by Lyons in 2002,[4] Neven and Röller in 2005,[5] and Fridolfsson in 2007[6]—more or less accept total welfare as the outcome standard for enforcement but suggest that, given various factors in the process of merger investigation and enforcement, a total-welfare-maximizing outcome might be more likely to result from an agency's use of consumer surplus rather than total welfare as its own standard.[7] In their 2006 paper, Farrell and Katz conclude a detailed discussion of both perspectives with a divided judgment between total versus consumer surplus as a standard—as we

1 U.S. Department of Justice & Federal Trade Commission, Commentary on the Horizontal Merger Guidelines (March 2006).

2 Ken Heyer, *Welfare Standards and Merger Analysis: Why Not the Best?*, 2(2) Competition Pol'y Int'l 29-54 (2006) and Dennis W. Carlton, *Does Antitrust Need to be Modernized?*, 21(3) J. Econ. Persp. (Summer 2007).

3 Thomas W. Ross & Ralph A. Winter, *The Efficiency Defense in Merger Law: Economic Foundations and Recent Canadian Developments*, 72 Antitrust L. J. 471-503 (2005).

4 Bruce R. Lyons, Could Politicians Be More Right than Economists? A Theory of Merger Standards (University of East Anglia, Centre for Competition and Regulation Working Paper CCR 02-1, May 2002).

5 Damien J. Neven & Lars-Hendrik Röller, *Consumer surplus vs. welfare standard in a political economy model of merger control*, 23 Int'l J. Indus. Org. 829-48 (2005).

6 Sven-Olof Fridolfsson, *A Consumer Surplus Defense in Merger Control*, *in* The Political Economy of Antitrust (Contributions to Economic Analysis, vol. 282) (Vivek Ghosal and John Stennek, eds., 2007).

7 As Kaplow and Shapiro summarize the argument: "[The enforcement agencies'] adopting a consumer welfare standard may induce firms to undertake deals that obtain potential synergies while causing less harm to competition, leading to even higher total welfare than would a total welfare standard." Louis Kaplow & Carl Shapiro, Antitrust (Nat'l Bureau of Econ. Research, Working Paper No. 12867, January 2007). *See also* Duarte Brito & Margarida Catalão-Lopes, Mergers and Acquisitions: The Industrial Organization Perspective (2006).

"muddle along until we understand more"—though they also join Foer in his 2006 paper in urging continued focus on the process of competition as an equally important end and standard in itself.[8]

The current paper presents one factor that arguably supports consumer surplus rather than total welfare as the outcome standard and follows with two factors supporting the argument that, even if one prefers total welfare as the outcome standard, a consumer surplus standard on the part of the enforcement agency is the best way to get there. In particular, I will argue that:

- it is both appropriate and workable to include distribution factors in the general (but not the specific) analysis of mergers;
- both the industrial organization and, especially, the finance literature cast some doubt on the tempting economists' assumption that because firms themselves propose mergers, we may assume that these mergers will increase at least the producer surplus portion of total welfare; and
- if the enforcement agency pursues total welfare as its standard, the outcome of the process in the United States and other countries is likely to be significantly biased in favor of producer surplus rather than total welfare.

II. The Welfare Outcome of Mergers: Must We Really Ignore Distribution?

"Who are you gonna believe? Me, or your lyin' eyes?"

—Richard Pryor

In the paper most often cited in support of total surplus as the standard for antitrust enforcement, Oliver Williamson points out that "the income redistribution which occurs [as a result of a merger] is usually large relative to the size of the deadweight loss."[9] Thus, notes Williamson, "attaching even a slight weight to income distribution effects can sometimes influence the overall valuation significantly."[10] Orley Ashenfelter and Daniel Hosken examine the impacts of five recent consummated mergers in large consumer goods markets and find that "the

8 Joseph Farrell & Michael L. Katz, *The Economics of Welfare Standards in Antitrust*, 2(2) COMPETITION POL'Y INT'L 3-28 (2006). *See also* Albert A. Foer, *The goals of antitrust: thoughts on consumer welfare in the US*, *in* HANDBOOK OF RESEARCH IN TRANS-ATLANTIC ANTITRUST (Philip Marsden, ed., 2006).

9 Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoff*, 58 AM. ECON. REV. 18-36 (1968), *reprinted in* 1(1) COMPETITION POL'Y INT'L (Spring 2005).

10 *Id*. at 28.

implied transfer from consumers to manufacturers is substantial."[11] My own analysis of one proposed U.S. rail merger may serve as a further example.[12] In the proposed merger of the Santa Fe and Southern Pacific Railroads in the mid-1980's, I estimated that transfers from shippers to the merged railroad would be anywhere from two to five times the value of the direct welfare loss, depending on the assumptions made regarding certain demand and cost parameters.[13] And yet the use of total welfare as a merger standard, combined with the refusal of mainstream neoclassical economics to consider assigning differing values for the marginal utility of income at different income levels, forces us to ignore these sometimes large transfers of income and wealth as beyond our concerns or specialized expertise.[14]

Must we really be so detached from these transfers? After all, it is difficult to ignore the rather plain evidence that, on average, firm owners are better off than final consumers—especially the owners of firms large enough to be subject to agency merger review—and that pure transfers from final consumers to owners, which are ignored as the total welfare standard is generally applied but included in a consumer surplus standard, are overwhelmingly likely to be regressive.[15] And there is some empirical support for the intuitively appealing notion that the marginal utility of income declines with income (i.e., that the Frisch parameter varies inversely with expenditure). Indeed this result is one of the factors behind Creedy's and Dixon's finding that market power for particular goods imposes a relative burden on consumers that also varies inversely with income.[16]

11 Orley Ashenfelter & Daniel Hosken, The Effects of Mergers on Consumer Prices: Evidence from Five Selected Case Studies (May 2007) (unpublished paper, Princeton University and Federal Trade Commission), at 4.

12 Russell W. Pittman, *Railroads and Competition: The Santa Fe/Southern Pacific Merger Proposal*, 39 J. INDUS. ECON. 25-46 (1990).

13 *Id*. at 36-37.

14 *See, e.g.*, RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE (1959); Arnold C. Harberger, *Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay*, 9 J. ECON. LITERATURE 785 (1971); and Louis Kaplow, *On the (Ir)Relevance of Distribution and Labor Supply Distortion to Government Policy*, 18 J. ECON. PERSP. 159 (2004).

15 This is not the place for an exploration of the legislative intent behind the Sherman and Clayton Acts, but Scherer's point regarding the former seems reasonable: "I believe . . . Congress was concerned at least as much with income distribution effects (which were well-understood in 1890) as with efficiency effects (which were not) . . ." F.M. Scherer, *The Posnerian Harvest: Separating Wheat from Chaff (review of Richard Posner, Antitrust Law: An Economic Perspective)*, 86 YALE L.J. 974-1002 (1977) (book review), at 979.

16 John Creedy & Robert Dixon, *The Relative Burden of Monopoly on Households with Different Incomes*, 65 ECONOMICA 285-93 (1998) and John Creedy & Robert Dixon, *The Distributional Impacts of Monopoly*, 38 AUSTL. ECON. PAPERS 223-37 (1999).

Regarding owners versus consumers broadly, the aggregate pattern of ownership of corporate assets in the United States is not much in dispute—and it certainly does not appear to be changing in the direction of less inequality. Using data from the most recent *Survey of Consumer Finances* from the Federal Reserve Board, Bucks and co-authors report that "ownership of any type of bond is notably concentrated among the highest tiers of the income and wealth distribution," and that "[t]he direct ownership of publicly traded stocks is more widespread than the direct ownership of bonds, but, as with bonds, it is also concentrated among high-income and high-wealth families."[17]

Kennickell elaborates in a 2006 paper:

> "In 2004, slightly more than one-third of total net worth was held by the wealthiest one percent of families. ... The next-wealthiest nine percent of families held 36.1 percent of total wealth. ... Families in the bottom half of wealth distribution ... held only 2.5 percent of total wealth."[18]

In other words, we can be pretty confident that, as a general matter, transfers of income and wealth to the owners of large firms from individual customers are transfers from the less to the more well-off.

Farrell and Katz (and others) would not, I think, dispute such points.[19] However, they argue against an enforcement agency's taking distributional considerations into account in merger analysis with what may be summarized as four points:

1. It would be very difficult to learn enough to take distribution into account in particular merger cases.
2. "[O]wners and workers of firms are people too," so that it is not clear why one should favor one group of people as consumers over another as producers. Furthermore, for some products like luxury goods, it is

17 Brian K. Bucks, Arthur B. Kennickell, & Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, 92 Fed. Reserve Bulletin A2 (2006).

18 Kennickell further notes that, while the first two of these figures have been stable in recent years, the share held by families in the bottom half "is significantly [below] ... the ... estimates for 1995, 1998, and 2001." Furthermore, "African Americans overall are 23.3 percentage points less likely to have direct or indirect holdings of publicly traded stocks than all families; Hispanics are 28.3 percent less likely." Arthur B. Kennickell, Currents and Undercurrents: Changes in the Distribution of Wealth, 1989-2004 (August 2006) (unpublished paper, Federal Reserve Board), at 10, 35.

19 Farrell & Katz (2006), *supra* note 8.

very likely the case that customers are better off than workers (though not necessarily better off than owners).

3. Many—perhaps most—mergers involve intermediate goods, whose sellers and buyers are both firms. "We are aware of no evidence that the wealth distribution of shareholders varies systematically according to a firm's place in the value chain."

4. Finally, there is a logical "division of labor among public policies: if antitrust enforcement and some other public policies focus on total surplus, other public policies can redistribute that surplus in accord with notions of fairness."[20] (In fact, the argument for this kind of division of labor goes back at least to William Musgrave's paper published in 1959).[21]

The first point is a strong one, but it clearly argues only against efforts to analyze the distributional consequences of individual merger proposals; it does not relate to the proposal in this paper to consider distributional concerns more generally. Farrell and Katz, in fact, point out—though they are arguing a different point—that "in the face of transactions costs, it is desirable to implement policies that work well on average (rather than exactly case by case) even when one has strong distributional preferences."[22] And, of course, antitrust enforcers (and courts) use similar reasoning every day in their per se prohibition of cartel agreements—though no one denies that there are situations (such as countervailing power against a monopolist) where the formation of a cartel may improve welfare. Those situations are considered insufficiently important to outweigh the strong presumption that, in general, cartels harm welfare such that detailed examination of every cartel agreement would impose investigative and adjudicative costs exceeding their social value.

Why, then, should we not conduct merger investigations as if most transfers from customers to owners are regressive, rather than treating them as benign by assumption? It is true, as Farrell and Katz note, that a good deal of merger activity takes place in markets for intermediate goods. It may be that we can say nothing about the progressivity or regressivity of transfers between different groups of owners, but that is not the end of the story. Most of us teach our students that cost increases—in this case, merger-induced transfers—generally get passed along. They may or may not get passed along 100 percent, but under most circumstances a significant portion is passed along. In their valuable 2000 paper that (among many other things) reviews the literature on this topic in the taxation and international trade arenas, Röller et al. suggest as a summary result "that

20 *Id*. at 11, 12.

21 Musgrave (1959), *supra* note 14.

22 Farrell & Katz (2006), *supra* note 8, at 11 n. 21.

pass-on roughly varies between 30% and 70%," depending of course on a variety of circumstances.[23] Generally, the (derived) demand curves for intermediate inputs are likely to be inelastic—purchasers will be relatively unresponsive to price increases so long as their competitors face the same increases. Thus, pass-on in this context should be at the high end of that range.[24] Heyer notes that:

> "[w]here final demand is inelastic and pass-through is likely to be nearly complete, intermediate goods customers may (correctly) believe that they will not be very much harmed by even a substantial post-merger increase in the price of what they buy. Final consumers, of course, are unambiguously harmed."[25]

It seems fully appropriate, then, to treat transfers to sellers from purchasers of intermediate goods as indirect, but real, transfers to sellers of intermediate goods from the final consumers of the goods that embody those intermediate goods.

In turn, this issue leads to a response to arguments that "if only consumers matter, then a buying cartel should be perfectly legal and indeed should be encouraged."[26] This may be true regarding buying cartels formed by final consumers, but it does not apply in the vast majority of merger cases that involve intermediate goods. As Schwartz noted, if a monopsonist lacks market power when it sells, then the monopsony has no impact on downstream customers and the entire harm from the monopsony is the upstream welfare loss. If the monopsonist has

23 Lars-Hendrik Röller, Johan Stennek, & Frank Verboven, Efficiency Gains from Mergers (Research Institute of Industrial Economics, Working Paper #543, 2000). *See also* the theoretical discussion in Jeremy I. Bulow & Paul Pfleiderer, *A Note on the Effect of Cost Changes on Prices*, 91 J. Political Econ. 182-85 (1983).

24 Indeed it is the relative inelasticity of the derived demand curve for the intermediate product that yields the common outcome of merger-induced transfers far exceeding merger-induced deadweight welfare losses.

25 *See* Heyer (2006), *supra* note 2, at 48.

26 Carlton (2007), *supra* note 2. *See* Heyer (2006), *supra* note 2, at 41 n. 28:

> It is worth noting that literal application of a pure consumer welfare standard . . . would appear to immunize consumer buyer groups that exert efficiency-reducing monopsony power over sellers. I suspect that many supporters of a consumer welfare standard for sellers would be uncomfortable applying its logic equally to the buyer side of the market.

See also Kaplow & Shapiro (2007), *supra* note 7, at 88 ("If only consumer welfare mattered, increases in buyer power through horizontal mergers and otherwise might be praised, not condemned.").

market power when it sells, then the low monopsony price that it pays for inputs is not passed along to its customers and so on downstream. On the contrary, it is the output reduction and associated welfare loss that are passed on, so that final consumers suffer rather than benefit.[27] It is only in the case of a buying cartel among final consumers that the arguments in this section would seem to imply approval rather than disapproval of monopsony. In this case, if the sellers possess market power then the cartel would not be condemned unambiguously even under a total welfare standard. In general, then, arguments for consumer surplus as a merger standard that are based on the ultimate effects of mergers on final consumers—as in this section of this paper—do not imply a tolerance for monopsony.

WE MAY CONCLUDE, THEN, THAT THE TRANSFERS FROM CUSTOMERS TO OWNERS THAT RESULT FROM SOME HORIZONTAL MERGERS ARE TYPICALLY REGRESSIVE, AND THAT SUCH TRANSFERS ARE LIKELY TO BE PASSED ALONG TO FINAL CUSTOMERS TO A SIGNIFICANT DEGREE EVEN IF THEY ORIGINATE IN INTERMEDIATE GOODS MARKETS.

We may conclude, then, that the transfers from customers to owners that result from some horizontal mergers are typically regressive, and that such transfers are likely to be passed along to final customers to a significant degree even if they originate in intermediate goods markets. I do not consider here the Schumpeterian argument that, on balance, market power is a good thing, because monopoly profits are a necessary incentive to innovation and the “creative destruction” that is capitalism at its most productive, except to note the strong theoretical and empirical argument that this effect is weakened or even reversed at a sufficiently high level of market power.[28]

I would argue, however, that it does not seem very satisfying or comforting to note that whenever total welfare increases, income redistribution policies could make everyone better off as a result[29]—if in fact they do not. The compensation principle[30] does not pay the rent. One may be happier when changes in government policies reduce the disparities of income and wealth within the United

27 Correspondingly, as Schwartz points out, we do not expect suppliers to monopolists to benefit from the high monopoly prices charged to the customers of the monopolist; rather, the suppliers suffer from the monopolistic output reduction. Marius Schwartz, Buyer Power Concerns and the Aetna-Prudential Merger, Presentation at the 4th Annual Health Care Antitrust Forum, Northwestern University School of Law, Chicago (October 20, 1999).

28 *See, e.g.*, Richard J. Gilbert, New Antitrust Laws for the “New Economy”?, Testimony before the Antitrust Modernization Commission, Washington, DC (November 8, 2005).

29 *See* Kaplow (2004), *supra* note 14, at 172.

30 W. Kip Viscusi, John M. Vernon, & Joseph E. Harrington, Jr., Economics of Regulation and Antitrust (MIT Press 4th ed., 2005).

States (not to mention the world), but until that happens it seems quite reasonable to argue that those making and enforcing other public policies, like antitrust enforcement, should, to the degree manageable, take into account the distributional implications of their actions. This would seem to argue in favor of a standard for merger and other antitrust enforcement focusing on consumer surplus rather than total welfare, as the latter is generally applied—that is, in favor of a merger standard centered on the effect of the merger on (quality-adjusted) price.

Ross and Winter point out that, while in the Williamsonian tradeoff a total welfare standard implies a weighting of increases in producer surplus equal to the weighting of increases in consumer surplus and a consumer surplus standard implies a weight of zero for producer surplus, one can imagine intermediate weighting schemes as well.[31] They argue, however, that antitrust should give no greater priority to income redistribution than other government policies do, and that, based on their analysis, the policies of the Canadian government—the focus of their case study—favor redistribution only on behalf of the very poorest members of society, as opposed to generally from the richer half (for example) to the poorer half. When they translate this policy into the weighting of transfers from consumers to producers generally, it does not much change the equal weighting scheme implied by a total welfare standard.[32]

The main problem with this line of thinking may be that the introduction of a weighting between zero and one for producer surplus reduces the predictability of enforcement by allowing enforcer discretion in the choice of weights.[33] Ross and Winter report some success in Canada with a methodology of solving for the weight which would cause an enforcement decision to change and then considering whether that weight seems reasonable, but that strategy certainly does not eliminate the problem. The more comprehensive answer from the Ross and Winter paper—that a proper weight for producer surplus would not be all that different from one, anyway—seems completely specific to the authors' analysis of broader Canadian distribution policies.[34] I know of no comparable analysis for the United States or other countries.

The *Horizontal Merger Guidelines* of the U.S. Department of Justice (DOJ) and U.S. Federal Trade Commission (FTC) use a standard that is close to a consumer surplus standard—favoring, for example, the inclusion of efficiencies into the analysis when said efficiencies are likely to be "sufficient to reverse the merger's

31 Ross & Winter (2005), *supra* note 3, at 475.

32 *Id*. at 491.

33 I thank Dennis Carlton for suggesting this point to me.

34 Ross & Winter (2005), *supra* note 3, at 488-91.

potential to harm consumers in the relevant market, e.g., by preventing price increases in that market."[35]

However, they make at least a nod in the direction of total surplus in the stated willingness of the agencies to consider, "in their discretion," significant efficiencies that are not likely to be passed along in the form of lower prices for the affected product, including both efficiencies in different markets and savings in fixed costs. In the latter case, the agencies note that "consumers may benefit from [these reductions in fixed costs] over the longer term even if not immediately."[36] In his 2007 paper, Carlton bases his case for total welfare on the longer term benefits of cost savings, especially as these lead to technological improvements.[37]

It may be worth noting here that Williamson himself expresses some reservations about ignoring distributional concerns—though, to be sure, in the end he does come down in favor of doing just that. He begins by making the "division-of-labor" in government policy argument himself, suggesting that "income distribution objectives … [fall] more clearly within the province of taxation, expenditure, and transfer payment activities."[38] Nevertheless, he also argues that:

> "[t]he transfer involved could be regarded unfavorably not merely because it redistributes income in an undesirable way (increases the degree of inequality in the size distribution of income), but also because it produces social discontent. This latter has serious efficiency implications that the … [traditional] analysis does not take explicitly into account."[39]

35 U.S. Department of Justice and Federal Trade Commission, Revised Section 4 Horizontal Merger Guidelines (April 8, 1997).

36 U.S. Department of Justice & Federal Trade Commission, Commentary on the Horizontal Merger Guidelines § 4 (March 2006).

37 Carlton (2007), *supra* note 2, at 3-4.

38 Williamson (1968), *supra* note 9, at 28.

39 *Id*. at 28. *See also* Dani Rodrik, *The Rush to Free Trade in the Developing World: Why So Late? Why Now? Will It Last?*, Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment, *in* (S. Haggard and S.B. Webb, eds., 1994) (discussing the issue of transfers versus efficiency gains in the context of development and the liberalization of trade policies). I thank Jim Leitzel for suggesting this paper to me.

He concludes this portion of his paper with the observation that "distinguishing social from private costs in this respect may . . . be the most fundamental reason for treating claims of private efficiency gains skeptically."[40]

III. How Much Deference Should One Give to the Assumption That Mergers Are (at Least) Privately Profitable?

"Assume a virtue, if you have it not."

—William Shakespeare,
The Tragedy of Hamlet

The economist's natural reaction to a proposed merger goes something like the following—if a company proposes a takeover, or two companies propose a merger, then we can assume that this transaction will be at least privately profitable.[41] This assumption will not, of course, turn out to be correct every time, but given information asymmetries and private incentives, we can assume that it will be profitable more often than not, and certainly more often than if the government second-guessed such private decision-making. Enforcers, then, should examine the likely effects of the merger on customers, but with the assumption that the fact of the merger itself implies a positive effect on at least the producer surplus portion of total welfare.

Unfortunately, the support from the empirical literature for this set of benign assumptions about merger motivations and outcomes is not particularly strong. There is, by now, a fairly extensive literature examining merger outcomes that includes a smaller industrial organization literature that relies mostly on accounting data and a much larger finance literature that relies mostly on stock market data. A surprisingly large number of studies in both areas come to the following conclusions:

- The stockholders of acquiring firms on average do not benefit, or do not benefit much, from mergers.

40 Williamson (1968), *supra* note 9, at 28.

41 Heyer (2006), *supra* note 2, at 38 ("Certainly the merging firms believe that they will be better off, as evidenced by the fact that they have chosen to merge, presumably, voluntarily."). *See also* Joseph Farrell, Michael L. Katz, & Carl Shapiro, *Horizontal Mergers: An Equilibrium Analysis*, 80 Am. Econ. Rev. 107-26 (1990) ("Since any proposed merger is presumably privately profitable, it will also raise welfare if it has a positive external effect [i.e., on consumers and on nonparticipant firms].") and Kaplow & Shapiro (2007), *supra* note 7, at 83 ("The law implicitly presumes mergers to be advantageous to some degree. . . . Setting the threshold of anticompetitive effects significantly above zero may be rationalized by the view that mergers typically generate some synergies, so they should not be prohibited unless the reduction in competition is sufficiently great.").

- The stockholders of acquired firms tend to enjoy significant gains from mergers.
- The balance of these two forces is probably a small overall efficiency gain from mergers, though even this is uncertain.
- These patterns vary, to some degree systematically, with the types of merger transactions.

The first result alone should give us pause concerning deference to the forecasts and incentives of acquiring firms. Presumably, even if the net effect ends up positive, it was not the intention of (the stockholders of) the acquiring firm to hand over most or all of the value of this gain to (the stockholders of) the acquired firm. And yet this seems to be the dominant empirical finding.

Among the studies reporting this outcome are those by Mandelker, Varaiya and Ferris, Bruner, and Moeller et al.[42] Dissenting voices include Andrade et al. and Kaplan.[43] Andrade et al. express well the problems raised by these findings:

> "A … challenge to the claim that mergers create value stems from the finding that all of the gains from mergers seem to accrue to the target firm shareholders. We would like to believe that in an efficient economy, … mergers would happen for the right reasons, and that their effects would be, on average, as expected by the parties during negotiations. However, the fact that mergers do not seem to benefit acquirers provides reason to worry about this analysis."[44]

42 Gershon Mandelker, *Risk and Return: The Case of Merging Firms*, 1 J. Fin. Econ. 303 (1974); Nikhil P. Varaiya & Kenneth R. Ferris, *Overpaying in Corporate Takeovers: The Winner's Curse*, 43 Fin. Analysts J. 64-70 (1987); Robert F. Bruner, *Does M&A Pay? A Survey of Evidence for the Decision-Maker*, J. App. Fin. 46-68 (2002); and Sara Moeller, Frederik Schlingemann, & René Stulz, *Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave*, 60 J. FIN. 757-82 (2005). *See also* Scherer (1977), *supra* note 15; David J. Ravenscraft & F.M. Scherer, Mergers, Sell-offs, and Economic Efficiency (1987), and F.M. Scherer, *A New Retrospective on Mergers*, 28 Rev. Indus. Org. 327-41 (2006). A recent business column in the *New York Times* cites "the adage that half of all deals destroy value." Andrew Ross Sorkin, *Dealbook: They're All No. 1, but Are They Worth It?*, N.Y. Times, August 5, 2007.

43 Gregor Andrade, Mark Mitchell, & Erik Stafford, *New Evidence and Perspectives on Mergers*, 15 J. Econ. Persp. 103-20 (2001) and Steven N. Kaplan, Mergers and Acquisitions: A Financial Economics Perspective, Presentation at the Antitrust Modernization Commission Economist's Roundtable on Merger Enforcement (January 19, 2006).

44 *See* Andrade et al., *supra* note 43, at 118.

The first, third, and fourth results together raise the obvious question, why would firms engage in mergers—perhaps particular types of mergers—that on average fail to increase profits? One answer may be the same as the answer to the classic microeconomic question as to why rational consumers would buy both lottery tickets and insurance—even if lottery tickets are on average a losing proposition, the small possibility of a very high return may act as an incentive for participation. Correspondingly, the parties may have been betting on the small possibility of a transformationally successful outcome, as, for example, in the AOL/Time Warner and Daimler-Benz/Chrysler combinations, which both turned out badly.

A number of more specific explanations have been proposed in the literature and found to have empirical support, many relying on the classic problem of the separation of ownership and control that goes back to Berle and Means.[45] Roll suggests a hubris hypothesis, with managers (and, possibly, their shareholders) overestimating the degree to which they can improve the operations of acquired assets.[46] Shleifer and Vishny suggest an empire building hypothesis, noting that the remuneration of top managers is more closely related to the size of the assets that they manage than the return that those assets earn.[47] Gorton et al. note the empirical regularity that larger firms are less often acquired, and suggest a motive of acquiring a smaller competitor in order to make the firm too large to be easily acquired by a larger competitor.[48] Fridolfsson and Stennek suggest a motive of acquiring the assets of a smaller competitor before one's competitors can acquire those assets.[49]

The fact that returns to mergers vary systematically with characteristics of the transaction seems to support these or related hypotheses. Gondhalekar et al. show that free cash flow in the acquiring firm is associated with overpaying for the acquired firm, while Bargeron et al. show that publicly held firms are more likely

45 ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

46 Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197-216 (1986).

47 Andrei Shleifer & Robert W. Vishny, *Value Maximization and the Acquisition Process*, 2 J. ECON. PERSP. 7-20 (1988).

48 GARY GORTON, MATTHIAS KAHL, & RICHARD ROSEN, EAT OR BE EATEN: A THEORY OF MERGERS AND MERGER WAVES (Nat'l Bureau of Econ. Research, Working Paper No. 11364, May 2005).

49 Incidentally, this theory suggests a weakness in the common assumption that a decline in the stock price of competitors following a merger announcement indicates that the merger will result in efficiencies. Fridolfsson and Stennek argue that this effect may simply reflect the market's reaction to the failure of the competitors to successfully purchase the acquired firm themselves. *See* Sven-Olof Fridolfsson & Johan Stennek, *Why Mergers Reduce Profits and Raise Share Prices—A Theory of Preemptive Mergers*, 3 J. EUR. ECON. ASS'N 1083-104 (2005) and Sven-Olof Fridolfsson & Johan Stennek, INDUSTRY CONCENTRATION AND WELFARE – ON THE USE OF STOCK MARKET EVIDENCE FROM HORIZONTAL MERGERS (Centre for Econ. Pol'y Research, Discussion Paper No. 5977, December 2006).

to overpay than privately held firms.[50] Andrade et al. show that acquirers who issue stock to finance an acquisition lose money on average, though they argue that this is largely due to the information disclosed by the issuance of the stock rather than to the acquisition itself.[51] (Amihud et al. suggest that this difference in returns to stock-financed acquisitions may be limited to those firms with low managerial ownership.)[52] Rau and Vermaelen show that acquirers that are glamour firms (or low book-to-market firms) systematically lose money with their acquisitions, in contrast to value (high book-to-market) acquirers that systematically gain.[53] Porter cites the strategy literature as demonstrating that "smaller, focused acquisitions are more likely to improve productivity than mergers among leaders."[54] Other studies have found a "negative correlation between acquirer announcement returns and both acquirer size … and the size of the merger transaction … as well as … worse acquirer returns in defensive acquisitions."[55]

THE IDEA IS THAT, IF FIRMS DO NOT IN FACT FORECAST THE PROFITABILITY OUTCOMES OF MERGERS WELL, THEN THE AGENCIES SHOULD NOT ADOPT THE DEFAULT ASSUMPTION THAT A MERGER WOULD ENHANCE THE PRODUCER SURPLUS PORTION OF TOTAL WELFARE SIMPLY BECAUSE THE FIRMS HAVE PROPOSED IT.

Again, the idea here is decidedly not that enforcement agencies should second-guess the decisions of firms to merge. If firms do not forecast the profitability outcomes of mergers well, enforcement agencies would do much worse. Nor is the point that enforcement agencies should be systematically more inclined to challenge those types of acquisitions that have been shown, on average, not to create value for the acquired firms—though it might be worth considering such a policy, especially if its likely effect, on average, were to discourage deals that reflect the furtherance of manager utility rather than the increase of shareholder value.

50 Vijay B. Gondhalekar, R. Raymond Sant, & Stephen P. Ferris, *The Price of Corporate Acquisition: Determinants of Cash Takeover Premia*, 11 APPLIED ECON. LETTERS 735-39 (2004) and LEONCE BARGERON, FREDERIK SCHLINGEMANN, RENE M. STULZ, & CHAD ZUTTER, WHY DO PRIVATE ACQUIRERS PAY SO LITTLE COMPARED TO PUBLIC ACQUIRERS? (Nat'l Bureau of Econ. Research, Working Paper No. 13061, April 2007).

51 *See* Andrade et al., *supra* note 43, at 111.

52 Yakov Amihud, Baruch Lev, & Nickolaos G. Travlos, *Corporate Control and the Choice of Investment Financing: The Case of Corporate Acquisitions*, 45 J. FIN. 603-16 (1990).

53 P. Raghavendra Rau & Theo Vermaelen, *Glamour, Value, and the Post-Acquisition Performance of Acquiring Firms*, 49 J. FIN. ECON. 223-53 (1998).

54 Michael Porter, *Competition and Antitrust: A Productivity-Based Approach*, *in* UNIQUE VALUE: COMPETITION BASED ON INNOVATION CREATING UNIQUE VALUE (Charles Weller, ed., 2005).

55 *See* Gorton et al., *supra* note 48, at 31.

Rather, the idea is that, if firms do not in fact forecast the profitability outcomes of mergers well—even as to the sign of the effects—then the agencies should not adopt the default assumption that a merger would enhance the producer surplus portion of total welfare simply because the firms have proposed it. Nor should the agencies put much stock in the existence or magnitude of efficiencies claimed by merging parties in their negotiations with the agencies. As Porter summarizes, "[w]e cannot assume that a merger will be efficient and profitable just because companies propose it."[56] And this leads us to the conclusion that if the analysis of the impact of a merger on competition and consumer surplus is what agencies and courts do best, that analysis is what they should rely on in deciding whether to challenge a merger.

IV. Is a Total Surplus Agency Goal the Best Way to Achieve a Total Surplus Process Outcome?

"By indirections find directions out."

—William Shakespeare,
The Tragedy of Hamlet

As noted earlier in this paper, there is a growing literature that examines the issue of the best standard for antitrust enforcement in the context of the process of enforcement—in particular, in merger enforcement, the clear and clearly relevant facts that:

a) firms choose which mergers to propose; and

b) agencies (and courts) are in some ways at a significant information disadvantage as compared to the merging firms.

Among the most important papers, Besanko's and Spulber's 1993 paper and Lyons' 2002 paper—both ably discussed by Farrell and Katz in their 2006 paper[57]—emphasize the incentives of the firms to choose among merger possibilities on the criteria of producer surplus only, so that a corresponding bias on behalf of consumer surplus at the enforcement agencies may be the most likely strategy to achieve an outcome favoring both producer and consumer surplus.[58] Fridolfsson explicitly outlines a scenario in which a consumer surplus bias at the

56 Porter (2005), *supra* note 54, at 19.

57 David Besanko & Daniel F. Spulber, *Contested Mergers and Equilibrium Antitrust Policy*, 9 J.L. ECON. & ORG. (1993) and Lyons (2002), *supra* note 4 (*discussed in* Farrell & Katz (2006), *supra* note 8).

58 There may be some parallel between the advantage of the firms in proposing the merger and the advantage gained by the member of a committee or legislature who controls the agenda. *See, e.g.*, DENNIS MUELLER, PUBLIC CHOICE III (2003).

agencies leads firms to consider alternative merger partners or strategies that they would have not considered otherwise.[59]

Unfortunately the existing literature on the topic of how the U.S. antitrust agencies choose which mergers to challenge—as well as other enforcement actions—is not very satisfying. Masson and Reynolds point out the methodological flaws in the literature of the pre-*Guidelines* period[60] and one of my own papers argues that the more recent literature claiming to demonstrate significant political influences on micro-level enforcement decisions of the agencies is badly flawed.[61] More recently, Baker and Shapiro present data suggesting that the U.S. agencies—and the DOJ's Antitrust Division in particular—have been considerably less likely to challenge mergers under the George W. Bush administration than under the Clinton and George H.W. Bush administrations.[62] In a forthcoming book, Stephen Martin has compiled data on total antitrust cases brought by the DOJ that show a similar pattern.[63]

But consider two potentially simpler issues:

(1) the internal structure of an enforcement agency; and

(2) the fact that, for the most part, and for most of the past quarter century, the heads of the agencies have sought to act as neutral judges rather than as aggressive prosecutors.

I believe that these two factors act to bias the decisions of the agencies against merger challenges and other enforcement actions—which may suggest, as with Besanko and Spulber and Lyons, that some countervailing bias, such as a focus on consumer surplus rather than total welfare, is appropriate even if the object is an outcome maximizing total welfare. I will focus here on the DOJ's Antitrust Division.

Within the Antitrust Division there are sections of lawyers organized either by economic sector (e.g., the Telecommunications and Media Enforcement Section, the Transportation, Energy, and Agriculture Section), by type of investigation and violation (e.g., the National Criminal Enforcement Section), or by

59 *See* Fridolfsson (2007), *supra* note 6, at 287-302.

60 Robert T. Masson & Robert J. Reynolds, *Statistical Studies of Antitrust Enforcement: A Critique*, PAPERS & PROCEEDINGS OF THE AM. STATISTICAL ASS'N part 1 (1977).

61 Russell W. Pittman, *Antitrust and the Political Process*, *in* EMPIRICAL STUDIES IN INDUSTRIAL ORGANIZATION: ESSAYS IN HONOR OF LEONARD W. WEISS (David B. Audretsch & John J. Siegfried, eds., 1992).

62 Jonathan B. Baker & Carl Shapiro, Reinvigorating Horizontal Merger Enforcement, Presentation at the Kirkpatrick Conference on Conservative Economic Influence on U.S. Antitrust Policy, Georgetown University Law School (April 2007).

63 STEPHEN MARTIN, INDUSTRIAL ORGANIZATION IN CONTEXT (2008) (forthcoming).

geography (e.g., the seven field offices). These "legal sections" are in turn supported by three economic sections—groups of economists who work with the lawyers as part of investigative teams but who report their analyses and recommendations to their own (economist) section chiefs.

Section chiefs of legal and economic sections report to Deputy Assistant Attorneys General (deputies), who are assisted by directors of operations. Deputies report to the Assistant Attorney General for Antitrust (AAG), who makes the enforcement decisions. Lawyers, economists, and section chiefs are career staff, while Deputies and the AAG are political appointees.

AN ARGUMENT TO CHALLENGE A PROPOSED MERGER IS, BY ITS NATURE, A SOMEWHAT FRAIL CREATURE WITHIN THE ANTITRUST DIVISION JUNGLE.

An argument to challenge a proposed merger is, by its nature, a somewhat frail creature within the Antitrust Division jungle. A judgment by both the legal and economic staffs that a proposed merger should not be challenged is rarely overruled by the two section chiefs involved. A judgment by both the legal and economic section chiefs that a proposed merger should not be challenged is rarely overruled by the legal and economic deputies. And a judgment by both the legal and economic deputies that a proposed merger should not be challenged is rarely overruled by the AAG. For the most part, no challenge is the default outcome.

Public choice economists and students of bureaucracy will respond that Antitrust Division lawyers are not random draws from the population. Lawyers who apply for work at the Antitrust Division are more likely to believe in its mission than those who do not. (Though, in fact, the majority of new Division attorneys have applied for a position at only the Department of Justice rather than a particular Division. Still, one could argue (a) there is a general pro-enforcement bias on the part of applicants to the Department; and (b) there remains the issue of which young attorneys offered jobs by the Division choose to accept.) Furthermore, Division lawyers arguably advance their careers and increase their human capital by getting a case into a courtroom. (I suggest elsewhere that it is difficult to argue seriously that Division economists—and, for that matter, FTC economists—are biased in favor of challenging mergers.)[64]

However, I would maintain that this (arguable) bias at the staff level is far outweighed by the notable lack of bias (arguably) at the section chief level and (reliably) at the deputy and AAG levels. This is a point apparently not much addressed in the literature. Two papers by Coate demonstrate the importance of perceived objective factors such as market concentration and entry barriers in leading to FTC merger challenges. These findings seem consistent with a lack of

64 Russell W. Pittman, *Review of Antitrust Policy and Interest Group Politics, by William F. Shughart, II*, 7 REV. INDUS. ORG. 91-95 (1992) (book review).

bias at the decision-making level of the sister agency of the Antitrust Division.[65] In related literature, Glaeser et al. suggest that both public interest and career furtherance are factors in certain decisions of federal drug enforcers.[66] This seems consistent with Posner's observation that the "aspirations for higher office or well-paying private employment" of the heads of administrative agencies "are enhanced if they earn a reputation for efficiency."[67]

I think most experienced observers would agree that at the Antitrust Division, not only both deputies—legal and economic—but also AAGs typically think and reach decisions in the mode of adjudicators rather than prosecutors. If they decide to go to federal district court to challenge a merger, they want to win the challenge, but they challenge only those mergers that they believe, on the merits, should be challenged.

Note what all of this means for the outcome of the Division's decision-making process. Even if Division attorneys are biased towards a merger challenge—even if Division attorneys and legal section chiefs together are biased toward a merger challenge—they are certainly no more biased than the lawyers of the merging companies that are biased against a challenge. (The rare formal and organized complaint by a competitor of the merging companies does not change this larger picture.)

But if, as I argue, the deputies and the AAG are not biased, this means that a recommendation to challenge at the staff level that is a close call on the merits has only about a 50 percent chance of making it past the deputies, and then only a 25 percent (50 percent multiplied by 50 percent) chance of making it past the AAG to an actual challenge. An unbiased federal district court judge reduces the chances of the merger being successfully blocked to 12.5 percent. (50 percent multiplied by 25 percent). (The reader can do the math regarding appeals.)

The broader point is a straightforward one. If deputies, the AAG, and the judiciary constitute three sequential decision makers seeking to maximize total welfare, and if there is little appeal from a first or second level decision not to challenge but a strong appeal to a decision at any level to challenge, then the system is going to be biased in the direction of not blocking mergers, including mergers that would reduce total welfare. Some may argue that this laissez-faire sort of bias

65 Malcolm B. Coate, Richard S. Higgins, & Fred S. McChesney, *Bureaucracy and Politics in FTC Merger Challenges*, 33 J.L. & Econ. 363-482 (1990) and Malcolm B. Coate, Twenty Years of Federal Trade Commission Merger Enforcement Activity (1985-2004) (Potomac Working Paper in Law and Economics 05-02, October 2005). *See also* the discussion by Leary, arguing for an intertemporal continuity of basic enforcement decisions at the two agencies. Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 Antitrust L.J. 105 (2002).

66 Edward L. Glaeser, Daniel P. Kessler, & Anne Morrison Piehl, *What Do Prosecutors Maximize? An Analysis of the Federalization of Drug Crimes*, 2 Am.L. & Econ. Rev. 259-90 (2000).

67 Richard A. Posner, Economic Analysis of Law 643 (Aspen 6th ed., 2003).

is appropriate. Others may reply, as Porter does, that existing accounting and tax conventions already provide artificial incentives for mergers.[68] In any case, if the desired outcome is one that maximizes total welfare, the analysis in this section suggests—in the same spirit as Besanko and Spulber and Lyons—that the best process to achieve that goal is more likely one where the enforcer seeks to add to the mix a bias in favor of consumer surplus. This is of course a fortiori the case if, as I have argued previously, the desired outcome should be one of the maximization of consumer surplus rather than total welfare as traditionally applied.

V. Conclusion

Mergers have a significant impact on the U.S. economy. When mergers are horizontal, they may reduce competition in such a way as to transfer large sums of money to the merged firm (and its competitors) from their customers. Conventional neoclassical economics treats these transfers as welfare-neutral, but I have argued that as a whole they are quite likely to be regressive and thus (arguably) welfare-harmful. This does not mean that enforcement agencies and courts should seek a detailed analysis of the distributional consequences of each horizontal merger. It does suggest, however, that enforcers and courts may assume that, on balance, such transfers are harmful rather than neutral (or "potentially" neutral), and use a consumer surplus standard in evaluating mergers, seeking to block those likely to result in price increases to customers. Two common arguments against this standard—that most mergers are in markets for intermediate goods, and that a consumer welfare standard implies a tolerance for monopsony—do not seem to withstand closer scrutiny. Note that this does not mean that estimates of efficiencies must always be ignored—a consumer surplus standard inherently includes any marginal cost reductions that are passed along to customers.

As noted above, the *Horizontal Merger Guidelines* of the DOJ and FTC elaborate an enforcement standard that is arguably close to a consumer surplus standard, focusing on the effect of a merger on the prices paid by customers, emphasizing the desirability of efficiencies lowering marginal costs so that they may have a direct impact on post-merger prices, and examining claims of efficiencies presented by the merging firms with great care. Thus, the argument in this paper is not really for a change in the status quo, and I do not argue strongly against the taking account of efficiencies in limited circumstances that is favored by the *Guidelines* and the recent *Commentary* thereto. However, several recent papers have called for the adoption of a total welfare standard rather than (close to) a consumer surplus standard, emphasizing in part the desirability of treating transfers as welfare neutral. It is this proposed change that would, all else being equal,

68 Porter (2005), *supra* note 54.

lead to less stringent U.S. merger enforcement against which I am specifically arguing.

Furthermore, it is clear from the finance literature that acquiring firms are poor predictors of the impacts of mergers on their shareholders. On average, acquiring firms in certain categories—and perhaps acquiring firms in general—do not benefit from the deals, though of course the managers who instigated the deals may benefit. This suggests strongly that, on average, the estimates of efficiencies prepared for the agencies by the acquiring firms are not to be trusted, even if the firms themselves believe them. (As noted above, Williamson urged skepticism regarding these estimates, especially the degree to which they reflect public rather than private efficiencies.) And this means that even agencies seeking to maximize total welfare should focus on the impact of the merger on customers, without trying to factor in the inherently unreliable company forecasts of cost reductions, except perhaps in very special circumstances.

Finally, the structure of the DOJ's Antitrust Division—and, I suspect, the FTC—is biased against merger challenges. At each level, a recommendation not to challenge is likely to prevail, while a recommendation to challenge faces a strong appeal from the parties in front of generally neutral top agency management. Under these circumstances, an attempt by the agencies to maximize total welfare will lead to too few merger challenges. A decision rule that seeks to maximize consumer surplus is more likely to lead to decisions to challenge at a level maximizing total welfare.

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Competition Policy International

Review of Elhauge & Geradin's *Global Competition Law and Economics*

John Kallaugher

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Review of Elhauge & Geradin's *Global Competition Law and Economics*

John Kallaugher

Professors Einer Elhauge and Damien Geradin begin the preface to their new casebook, *Global Competition Law and Economics*, by observing that "[n]o one would think of writing a casebook on Massachusetts antitrust law."[1] They then suggest that for similar reasons an approach to antitrust law based on a single legal system is also becoming outmoded. Businessmen, lawyers, and lawmakers must, according to the authors, understand not just their own system but also "the other regimes that form part of the global legal framework that regulates competitive behaviour." This leads them to conclude that "[m]odern antitrust law is thus global antitrust law."[2] While they acknowledge that significant differences remain between U.S. antitrust law and EC competition law, they see these differences as reflecting "different presumptions about how to resolve theoretical or empirical ambiguities," arising in a commonly accepted analytical framework. The authors are therefore convinced that the "combination of laws from varying nations in actual practice provides a truer picture of the overall regime of com-

1 Einer Elhauge & Damien Geradin, Global Competition Law and Economics (Hart Publishing 2007) [hereinafter Elhauge & Geradin]. The book was also published in the United States under the title, Global Antitrust Law and Economics (Foundation Press 2007).

2 *Id*. Although the title of the book refers to "Global Competition Law," the authors choose "antitrust" as the blanket expression for competition or antitrust laws in the text.

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petition law that now faces multinational players."[3] They present their work as "a book designed to replace more parochial books on *basic* antitrust law by giving a more realistic sense of the range of issues and analyses relevant to modern antitrust law wherever practised."[4] (Emphasis in the original)

Given these bold claims, it is appropriate in reviewing this work to consider the validity of the authors' premise that modern antitrust law constitutes, in some meaningful way, a global legal regime. It is also appropriate to discuss the extent to which the materials as presented in the book vindicate the authors' conviction that a global approach is the best way to present basic antitrust law to students. Before dealing with these fundamental questions, however, a short description of the book itself is in order.

I. The Book

Global Competition Law and Economics is a case book that will find its primary market among students and teachers of antitrust law. The book may also be useful to practitioners who wish to review the basic case law in a particular area. Its general value as a reference work is limited, however, because, with some exceptions, it does not attempt to survey the academic literature or excerpt secondary materials other than those prepared by one of the authors.

Following an introductory section that includes useful overviews on the law and remedial structure in the United States and the European Community, the book is set out in eleven chapters addressing general themes such as "Which horizontal agreements are illegal?," "Vertical agreements that restrict dealing with rivals," or "Agreements that arguably distort downstream competition in distributing a supplier's products." Each chapter is divided into smaller sections (e.g., "horizontal price-fixing"). Within these smaller sections, the authors present passages from the leading cases, as well as passages from the guidelines issued by the U.S. enforcement agencies, European Commission interpretive notices, EC block exemption regulations, and the Article 82 EC discussion paper. These primary materials are interspersed with detailed questions, short summaries of other cases, and explanatory commentary. In some sections, U.S. and EC law are set out separately, but sometimes they are presented as a single body of law, leaving the questions and commentary to point out any differences between the systems. Following the U.S. and EC legal materials, each section usually has a short, final subsection that discusses the law in other jurisdictions.

The cases and other primary materials are generally well-chosen and well-edited. The extensive questions should help the student to understand the implica-

3 *Id*. at vi.

4 *Id*.

tions of the materials. The sometimes lengthy explanatory commentary is thoughtful and clear. Economic concepts, in particular, are presented in a clear and largely jargon-free fashion. In short, this book has substantial merit as a university text, depending on one's view of the authors' underlying approach.

II. Is Modern Antitrust Law Really "Global Antitrust Law"?

Twenty years ago, no one would have seriously suggested that antitrust law or competition law constituted a worldwide legal order. The differences between the U.S. antitrust law and EC competition law were fundamental and appeared to reflect fundamental differences in policy goals. Today, convergence is "in the air." The introduction of merger control at the EC level has led to a shift to an explicitly economics-based approach in Europe. The abolition of the old exemption system has removed the most fundamental structural difference between the two systems. Enforcement officials in the United States and the European Community are in regular communication. EC regulators, practitioners, and academics have received a respectful reception at U.S. hearings on the antitrust-intellectual property interface and on the rules applicable to unilateral conduct. Furthermore, as Elhauge and Geradin emphasize in their preface, there is substantial agreement on the goals of antitrust and competition rules—promotion of consumer welfare—and on the analytical framework appropriate for applying those rules. Nevertheless, the question remains whether convergence has reached a point where it is useful to treat U.S. law and EC law as a single system of law in the same way that an American book on contract law would treat the contract law of the various states as a single body of law.

TWENTY YEARS AGO, NO ONE WOULD HAVE SERIOUSLY SUGGESTED THAT ANTITRUST LAW OR COMPETITION LAW CONSTITUTED A WORLDWIDE LEGAL ORDER. THE DIFFERENCES BETWEEN THE U.S. ANTITRUST LAW AND EC COMPETITION LAW WERE FUNDAMENTAL AND APPEARED TO REFLECT FUNDAMENTAL DIFFERENCES IN POLICY GOALS. TODAY, CONVERGENCE IS "IN THE AIR."

The example provided by Elhauge and Geradin in their preface may assist in answering this question. The reason that no one would think of publishing a casebook on Massachusetts antitrust law is that Massachusetts antitrust law is primarily based on the U.S. Sherman Act and other federal antitrust law.[5] Advice on Massachusetts antitrust law is often based on precedent from the Supreme Court and other federal courts. In the absence of specific Massachusetts precedents or rules, legal argument before the Massachusetts courts relies on those federal precedents. A lawyer from California or New York feels comfortable advising clients

5 U.S. Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (2000 & Supp. IV 2005).

that operate across the United States on antitrust issues on the basis of the federal antitrust laws, recognizing that on some issues (usually dealing with consumer or dealer protection) attention to local state law may also be required. Thus, Massachusetts antitrust law can really only be understood as part of a national system. It would not make sense to try to teach Massachusetts law separately and few students would be interested in a course that was so limited.

The same analysis is also applicable to national competition law within the European Community. In many EU Member States, the law developed under Articles 81 and 82 of the EC Treaty is directly applicable under the relevant national law. Even where EC competition law is not directly binding, concurrent application of EC law and national law means that a practitioner needs to be able to apply both national and EC law. The various national laws and EC competition law, therefore, do form a system. It would not make sense to teach national competition law in individual EU Member States on its own, even in countries such as Germany where the national law is well-developed, unless the students already had a thorough grounding at the EC level.

It is clear that the same level of integration does not exist between the U.S. and EC antitrust systems as exists between the law of an individual U.S. state and U.S. federal antitrust law. This does not necessarily invalidate the Elhauge-Geradin approach, but it does mean that the logic of going beyond a concentration on the U.S. antitrust system or the EC competition law system as the focus for a student text is not self-evident. The challenge facing a business that must comply with antitrust rules affecting agreements with customers in multiple jurisdictions is, in principle, not different from the challenge involved with complying with rules governing advertising or product safety. In each case, the public policy concerns are the same and the basic analytical approach will usually be the same, yet we would not necessarily consider the law on advertising standards or product safety law to constitute a "global" legal system. The need to clear large international transactions in multiple jurisdictions also does not necessarily make antitrust law "global." In the vast majority of cases, the issues raised by such filings are procedural (e.g., filling in the proper forms, obtaining the required information, delaying the "closing" until clearance is obtained). Where substantive issues do arise, they are more likely to be local than international in scope.

It is undeniably useful for lawyers trained in one system to be capable of also working in a different system. It is arguably essential for lawyers working in an international environment to be aware of the significant points of difference between their own legal system and other systems in which they have contact. But this does not make antitrust law global. Ultimately, no lawyer can claim to practice global antitrust law or offer advice on a truly global basis.

In fairness to Elhauge and Geradin, the approach that they take in their book does not really depend on their contention that antitrust law is global. The true basis for their approach appears to be the contention that modern antitrust law, wherever it is practiced, is based on a common analytical framework supported by a common body of scholarship. Here they are on much firmer ground. The primacy of welfare goals and economic analysis as the basis for achieving those goals is, indeed, broadly accepted.[6] The basic structure of analysis is largely the same worldwide. For example, all jurisdictions differentiate between competitor agreements and single-firm conduct. All jurisdictions recognize that traditional cartels are harmful, but accept that some horizontal agreements are beneficial. All jurisdictions recognize that proving market power is an essential element in finding a welfare loss outside the realm of pure price-fixing or market-division arrangements. And all jurisdictions look to market definition as a key tool for assessing market power in most circumstances. Furthermore, the agreements or conduct that give rise to antitrust policy concerns are largely the same. The biggest challenge that faces any teacher of antitrust law is helping students to understand and apply this basic analytical framework. Presenting EC competition law and U.S. antitrust law as a single body of law reflecting "a range of issues and analyses" could provide an effective way to meet that challenge.

THE BIGGEST CHALLENGE THAT FACES ANY TEACHER OF ANTITRUST LAW IS HELPING STUDENTS TO UNDERSTAND AND APPLY THIS BASIC ANALYTICAL FRAMEWORK. PRESENTING EC COMPETITION LAW AND U.S. ANTITRUST LAW AS A SINGLE BODY OF LAW REFLECTING "A RANGE OF ISSUES AND ANALYSES" COULD PROVIDE AN EFFECTIVE WAY TO MEET THAT CHALLENGE.

At this point, the real issue becomes what a course on basic antitrust law is meant to achieve. Is the goal of a basic antitrust course to give students the basic skills they need to practice as lawyers in a law firm, a business or in regulatory agency? Or is the goal of a basic antitrust course simply to give students the analytical tools for dealing with antitrust problems, in the expectation that they can pick up the specific legal rules later on? If the primary goal is indeed simply to help students understand and apply the analytical model (which, as already noted, is the most difficult part of teaching an antitrust course), then there can be no objection to presenting antitrust law as a global phenomenon. This approach is particularly appropriate if the great majority of students in a course will work in countries where neither U.S. nor EC law is directly applicable. In other cases, however, there is still some expectation that a basic antitrust law course will give a student the ability to apply the law in practice. To the extent that a basic antitrust course is still, at least in part, vocational training, there may be a risk that the global antitrust approach could make it more diffi-

6 Acceptance of welfare maximization and economic efficiency as the reference points for competition policy is still not universally accepted, however. See, for example, recent critical remarks by the Chairman of the Germany Monopoly Commission and Director of the Max Planck Institute in Hamburg. J. Basedow, *Konsumentenwohlfahrt und Effizienz—Neue Leitbilder der Wettbewerbs-politik?*, 57 WIRTSCHAFT UND WETTBEWERB 712 (2007) (concluding that welfare and efficiency cannot be exclusive goals of competition policy and that "free competition" is a key policy goal in itself).

cult for students to achieve the level of practical understanding provided by a more traditional course.

III. Does the Global Approach Work?

There are two real risks associated with use of a global antitrust approach for a basic course on antitrust law, where the goals of the course include the vocational element identified above. The first is that in presenting materials from two systems to demonstrate a range of approaches to a common issue, the approach or range of approaches appropriate in either jurisdiction may be obscured. The second is that the global approach could de-emphasize the unique aspects of either system. *Global Competition Law and Economics* illustrates both of these risks.

An example of the first risk is the topic described by the authors as "Standards for Finding a Horizontal Agreement or Concerted Action."[7] The authors provide 64 pages of materials on this topic, including lengthy excerpts from eleven U.S. cases and four EC cases. They use these materials to explore a range of issues regarding the difference between parallel behavior and collusion, and the circumstances in which agreements or practices may facilitate oligopolistic conduct. These materials do illustrate one of the benefits of the global approach, since they permit students to consider a range of practical issues that even a U.S.-based course might not cover so fully. But despite the short introductory text summarizing the approach of the two systems, a student may be challenged, on the basis of these materials, to define what a "concerted practice" actually means under Article 81 EC.

A second example that demonstrates the risk that a global treatment may obscure the legal approach appropriate in a specific jurisdiction is the treatment of refusals to deal. This is an area where most commentators see fundamental differences in the approach under Article 82 or Section 2 of the U.S. Sherman Act. Yet the questions and commentary in *Global Competition Law and Economics* present the leading U.S. and EC cases as taking a basically common approach. This may reflect the authors' view that the essential facility doctrine in the U.S. courts remains viable and that U.S. antitrust law does not bar antitrust liability for refusal to license intellectual property rights. But the authors do not consider whether it matters that the U.S. cases involve monopolization in the downstream market, where the EC cases all involve leveraging of market power in the input market. The authors also do not consider whether the *Trinko* approach to defining antitrust liability in the context of a regulated industry would apply in the European Community.[8] It is at least arguable that the focus on common

7 Elhauge & Geradin, *supra* note 1, at 734-73.

8 *See* Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

themes makes it more difficult for the student to define the specific EC legal rules in this context.

With regards to the second risk—de-emphasizing the features specific to either jurisdiction—the authors make an effort to cover those areas where either U.S. law or EC law is silent. They discuss, for example, excessive pricing and collective dominance under EC law and attempted monopolization under U.S. law.[9] The bigger problem, however, is the relation of legal rules to the procedural and political context of each jurisdiction. An example of this problem is the question of procedure in merger cases. For most practitioners, the biggest difference between EC merger law and U.S. law is that the EC procedure is primarily based on written submissions and leads to an administrative decision prohibiting or allowing a merger, while U.S. procedure is document-based and leads to a decision by the relevant agency on whether to seek injunctive relief. This fundamental difference in procedure explains most of the differences between U.S. and EC law in this area. Yet in over 200 pages of materials on mergers, the authors devote only a brief introduction to procedural issues and do not address the impact that differences in procedure may have on substantive analysis. The focus of the authors on the common structure of substantive analysis thus arguably obscures an issue that is central to understanding the law as practiced in either jurisdiction and important from a traditional comparative law perspective as well.[10]

It should be stressed that these kinds of problem are largely inherent in the global antitrust approach. While a more traditional comparative law approach (treating each jurisdiction's rules separately but in parallel) might make the rules in each jurisdiction clearer, it would probably result in a different and less interesting work. Adding further information and commentary to the text that deals with the issues noted above would only make an already lengthy text longer still, without necessarily rendering it clear. The question, therefore, arises whether these difficulties invalidate the approach used in *Global Competition Law and Economics*.

This reviewer is not convinced that the authors have succeeded in rendering existing parochial texts obsolete. Nonetheless, this remains a very strong work.

9 ELHAUGE & GERADIN, *supra* note 1, at 360. In discussing excessive pricing, the authors slip in describing the control over unfair prices in the European Community as a position developed by the courts, rather than as one mandated by the EC Treaty itself. This may reflect their general tendency to view differences between the jurisdictions as policy judgments rather than as (sometimes accidental) differences in legal structure. In discussing attempted monopolization, the authors may miss one potentially significant point from a comparative perspective—does the lower threshold for possible dominance under Article 82 EC not, in fact, make many Article 82 cases really cases of attempted monopolization?

10 A similar issue may be raised by the failure to deal in detail with the structure of an Article 81(3) EC analysis in the context of either horizontal or vertical agreements. Combined with the tendency to treat U.S. per se analysis as essentially similar to analysis in EC cases under Article 81, the focus on supporting the common analytical structure may make it more difficult for the student to discern the formal analysis required to perform a self-assessment under Article 81.

It is particularly suited for use in courses where students are less likely to practice in the United States or European Union following conclusion of their studies. For U.S. or EU students, this book could also be the foundation for an interesting and sometimes provocative course. It will take a lot more work from both teacher and students, however, to derive from these materials the information necessary to practice in either jurisdiction.

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Competition Policy International

Law and the Future: Trade Regulation (1956)

Aaron Director & Edward H. Levi with a Note by Keith Hylton

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A Note on Director & Levi (1956)

Keith Hylton

In their uninformatively titled article, "Law and the Future: Trade Regulation,"[1] Director and Levi set out a research agenda as well as some of the major propositions of what later came to be known as the Chicago School of antitrust. A better sense of its eventual importance to the antitrust literature would have been conveyed if the article had been titled "The Chicago School of Antitrust: A Manifesto." Of course, calling the article "The Chicago Manifesto" would have made the title more informative today, but less informative when it was written.

Therein lies the story of one of the most successful intellectual innovations of the legal academy. For when Director and Levi wrote "Law and the Future," the Chicago School of Antitrust was relatively unknown outside of the University of Chicago Law School, and even there, consisted of nothing more than critical discussion of antitrust cases in the classroom of one Aaron Director.

We are all familiar with the importance of those arguments today, primarily through the impression that they made on Director's students. The Chicago School of Antitrust has arguably become the core of serious antitrust analysis. "Law and the Future" is the only published article in which Director himself, rather than one of his students, sets forth the Chicago School arguments. The article discusses the economic analysis of market power, abuses of market power, and collusion.

1 Aaron Director & Edward Levi, *Law and the Future: Trade Regulation*, 51 Northwestern L. Rev. 281 (1956), *reprinted in* 3(2) Competition Pol'y Int'l 253 (2006).

The author is a Professor of Law at Boston University School of Law and co-editor of *Competition Policy International*.

Of the major Chicago School arguments, the one that receives the most attention is the "single monopoly power" thesis, which holds that various leveraging strategies such as tying cannot expand the monopoly power of a firm because any attempt to impose additional restrictions on consumers, beyond the monopoly price and output combination, will require concessions from the monopolist. Director and Levi briefly note that the single-power proposition does not necessarily apply when the monopolist adopts constraints that burden rivals more than itself, a view later explored in the post-Chicago literature.

Law and the Future: Trade Regulation

Aaron Director and Edward H. Levi***

Originally published in *Northwestern University Law Review*, Vol. 51, No. 281, 1956. Reprinted by special permission of Northwestern University School of Law, *Northwestern University Law Review*.

In this note we do not attempt to predict the future of the anti-trust laws. Rather we wish to direct attention to certain problem areas for study. We assume for the purposes of this discussion that an over-riding belief in both free enterprise and in competition will prevail over future possible NRA attempts. We assume also that despite the extension of a government regulation of one form or another, there will still be a place for regulation by competition. The ability of the antitrust laws in weathering NRA and government regulation attempts in the past provides a basis for assuming the laws will continue. The durability of the antitrust laws is perhaps their main characteristic. In large measure, this is a common law durability, built on a case by case development, and exhibiting that flexibility is now limited by particularizing legislation enacted to accompany the Sherman Act. Throughout its history, indeed, the Sherman Act has exhibited the twin tendencies of flexibility and ambiguity, on the one hand, and a drive for certainty and automaticity, on the other. At the moment, the drive for certainty and automaticity seems paramount, but not without criticism and reaction. Much of this drive for certainty rests not so much on the concept of fair warning, which is inherent in any idea of the rule of law, but rather more on the belief that new and automatic applications of the laws will catch objectionable conduct and effects in their incipiency. The idea of incipiency seems to rest of economic doctrines, or, conclusions drawn from experience. Because of these doctrines or conclusions, certain types of conduct are deemed harmful in themselves, although the harm in the particular case may not be visible. Economic theory or experience thus substitutes for an observed effect.

*Professor of Economics, University of Chicago Law School. Ph.D., Yale Univ., 1924.

**Professor of Law and Dean, University of Chicago Law School. Ph.D. Univ. of Chicago, 1932, J.D., 1935; J.S.D., Yale Univ., 1938.

In no area, of course, is the law self-contained, that is, completely independent of the teachings of other disciplines or the assumptions, which may change, of underlying philosophy. The common law, itself, provides the mechanism for moving from doctrines outside the law into felt distinctions which make the law. As much as any field of law, however, and more than most, the antitrust laws in their evolution have exhibited an explicit interdependence with economic and political thought. Many of the cases, of course, reflect the law's skepticism for economists and economics.[1] But the antitrust laws have been greatly influenced by economic doctrine. At times the legal and economic theory have appeared to be the same. New problems for the antitrust laws are therefore created if it an be shown that, in term of present day situations, much of the reliance on economic doctrine if unjustified. Even if this can be shown, it is possible, perhaps probable, that the law will continue on its own, for the law is not economics. The main lines of the law, then, may remain the same, but the statement of reasons for the law may change, and this in itself should have an interstitial effect in the cases. Indeed, there is uncertainty whether the dominant theme of the antitrust laws is to be the evolution of laws of fair conduct, which may have nothing whatever to do with economics, or the evolution of minimal rules protecting competition or prohibiting monopoly or monopolizing in an economic sense. But this uncertainty only becomes meaningful as the issues concerning the underlying economic doctrines are sharpened.

We believe the conclusions of economics do not justify the application of the antitrust laws in many situations in which the laws are now being applied. We conclude, therefore, that there are new problems for the antitrust laws, and that the future perhaps will be occupied, at least in part, with their resolution. The new problems for the antitrust laws have to do with size, the concept of abuse, and with the application of the idea of collusion. They exist, therefore, in the central field of antitrust enforcement.

The problems are new. The earlier history of the Sherman Act involved its enforcement against units of great relative size which had acquired that position largely through mergers and acquisitions and which, in most cases, had engaged in conduct which was characterized as abusive. Under this analysis, there were three elements combined in the cases. First, there was great relative size. Since the relative size which was reached, although not always maintained, was sufficiently great, the firm could be characterized with some assurance as a monopoly, and its behavior in an important respect could be predicted. Second, this size was obtained through acquisitions. Great importance could be attached to this method of growth. A perennial fear in the application of the Sherman Act is that it will cut down units which have grown to great size only because of the economies of large scale, that is, in response to the demands for efficiency. But

1 See United States v. United States Steel Corp., 251 U.S. 417, 448 (1920). *Cf.* FTC vs. Cement Institute, 333 U.S. 683, 715 (1948).

during this earlier period, the means of growth used by monopolies in many industries were mergers or acquisitions. It could be argued, although not without some doubt, that, presumptively, growth because of the economies of large scale would not take the form of merger or acquisition in so many industries. The underlying rationale behind this presumption is that it would strain credulity to believe that in so many industries the ideal arrangement for one firm would be merely the collection into one ownership unit of factories which were originally justified as parts of separate forms. In the reasoning of the law, the method of growth through mergers or combination thus could be used as some evidence of intention to monopolize, and as an answer to the efficiency argument. Third, there was present also conduct frequently described as abusive. There were instances of price cutting, exclusive arrangements or tying clauses, the receipt of rebates, and full line forcing. Perhaps this conduct was important because it colored the origin of the monopoly. Perhaps it was important because it characterized the way the monopoly was used. But since the abuses accompanied great relative size acquired through combination, no really separate decision had to be made as to whether it was these abuses which caused illegality. The abuses might have been merely incidental features of monopolies which were illegal because they had arrived at such size without the justification of efficiency.

But since the abuses accompanied great relative size acquired through combination, no really separate decision had to be made as to whether it was these abuses which caused illegality. The abuses might have been merely incidental features of monopolies which were illegal because they had arrived at such size without the justification of efficiency.

The old *Standard Oil* case reflects this union of size, combination, and abuses. It was the "unification of power and control over petroleum and its products which was the inevitable result of the combining in the New Jersey corporation . . . aggregating so vast a capital" which gave rise "in the absence of countervailing circumstances, to say the least, to the *prima facie* presumption of intent and purpose to maintain the dominancy over the oil industry. . . ."[2] And this presumption was then made conclusive by considering conduct and results. This analysis left unanswered the question of the importance of the abuses in determining illegality. Specifically, it was not settled whether given sufficient size acquired through combination, an injury through abuses of that power would have to be shown to spell out a violation of the Sherman Act. As Judge Hand wrote in the *Corn Products* case, "perhaps it is yet an open question whether or not the test is to be found only in the combination of enough producing capacity to control supply and fix prices, or whether it must be shown that the combi-

2 Standard Oil of N.J. v. United States, 221 U.S. 1, 75 (1911).

nation had injured the public in the exercise of power."[3] But the combination of factors made it unnecessary to decide this question in *Corn Products*. There was also an open question as to the status of power less than monopoly but acquired through past abuses. This was the question which might have been reached in the *United States Steel Corporation* case[4] if past abuses had been found. But the *Steel Corporation* case, itself, marks a turning point. It is the beginning of the modern period for the Sherman Act when, with few exceptions, industrial combines are not monopolies. Some of the firms indeed might have been monopolies in the past, but there was little likelihood for most of them that such large relative size would be acquired again.

Today the industrial pattern is far different than it was at the beginning of the century. It is much less common than it was to have an industry in which one firm has seventy or more percent control over productive capacity or sales. There are likely to be at least three or four units of considerable relative size in an industry. The absolute size of these firms may be much greater than that once possessed by any single dominating firm. And large absolute size, of course, carries with it a power of its own. But it confuses concepts to call this monopoly power. And there is an additional change. The role of combination appears to be different. Whatever the ultimate conclusion may be, it has not yet been shown that such industrial concentration as exists is due in any widespread way to recent mergers and acquisitions. And this cannot be shown, of course, merely by counting the number of mergers and acquisitions which occur annually. The application of the antitrust laws to firms of less than monopoly size or to firms which acquired their size without combination presents new problems for the antitrust laws.

The *Aluminum Co.* case[5] hits one of these problems head on. The big step taken in *Alcoa* was to find illegality, perhaps without abuses, but in any event without recent combination. This finding of monopolizing without combination raises a serious question as to the application of the antitrust laws to monopolies born solely out of efficiency. The presence of combinations in the older cases was supposed to provide the necessary presumption that the growth in the form taken was not due to the drive towards efficiency and appropriate scale. Mergers thus appeared to minimize the point raised in *Alcoa* that monopoly may "have been thrust upon" the firm, and thus to satisfy, as Judge Hand indicates, the older cases on the question of "natural" or "normal" conduct, or on the question of intent.[6]

3 United States v. Corn Products Refining Co., 234 Fed. 964, 1011 (S.D.N.Y. 1916). "If, however, it shall be eventually decided that it is the exercise of the power . . . and not the power alone, which is illegal, the case at bar is in the end no different. Under that theory the injuries to the public are shown by the means which the combination has employed in its efforts either to gain or to maintain its position" *Id*. at 1012.

4 United States v. United States Steel Corp., 251 U.S. 417 (1920).

5 United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

6 *Id.* at 429.

Absent combination and abuses, it is possible to decide, as *Alcoa* appears to do, that monopoly as such is illegal as monopolizing. This means that the law has decided the monopoly behavior is not dependant on the circumstances which gave rise to the monopoly, and that perhaps even with access to an industry open, and without collusion, monopoly is not sufficiently self correcting. If stated without qualification, this would mean that a firm which grew to monopoly size because of the economies of large scale nevertheless would be illegal. The consequences of the law would be a less efficient system of production. This would not necessarily be a decisive criticism of the law, for, as Hand tells us, the Sherman Act has other objectives. The Congress which passed the statute, he reminds us, "was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.[7] And this maintenance of an organization of industry in small units was to be "in spite of possible cost."[8] Yet despite this language, the *Alcoa* opinion attempts to carve out a place for the argument of efficiency as a defense.

The *Alcoa* position on efficiency as a defense is somewhat complicated. The "successful competitor," we are told, "having been urged to compete, must not be turned upon when he wins."[9] The opinion draws a distinction between monopoly which has been "achieved" and monopoly which was been "thrust upon" the firm.[10] Persons "may unwittingly find themselves in possession of a monopoly, automatically, so to say; that is without having intended either to put an end to existing competition, or to prevent competition from arising when none had existed; they may become monopolists by force of accident."[11] Three illustrations are given:

> "A market may, for example, be so limited that it is impossible, to produce at all and meet the cost of production except by a plant large enough to supply the whole demand. Or there may be changes in taste or in cost which drive out all but one purveyor. A single producer, merely by virtue of his superior skill, foresight and industry."

7 *Id.* at 427.

8 *Id.* at 429.

9 *Id.* at 430.

10 *Id.* at 429.

11 *Id.* at 429-30.

The language appears to give full consideration to the requirements of efficiency. But there is balancing language on the other side. The issue for Alcoa is posed in this fashion: "The only question is whether it falls within the exception established in favor of those who do not seek, but cannot avoid, the control of a market."[12] On this issue, Judge Hand writes:

> "It was not inevitable that [Alcoa] should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connection, and the elite of personnel. Only in case we interpret 'exclusion' as limited to maneuvers not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued be deemed not 'exclusionary.'"

Perhaps, then the successful competitor can be turned open when he wins, because he has been told not to compete.

Judge Wyzanski, in his opinion in the *United Shoe Machinery* case, describes the doctrine announced by Judge Hand in *Alcoa* as determining that "one who has acquired an overwhelming share of the market 'monopolizes' whenever he does business . . . apparently even if there is no showing that his business involves any exclusionary practice."[13] "But," Judge Wyzanski's opinion continues, "it will also be recalled that this doctrine is softened by Judge Hand's suggestion that the defendant may escape statutory liability if it bears the burden of proving that it owes its monopoly solely to superior skill, superior products, natural advantages (including accessibility to raw materials or markets), economic or technological efficiency (including scientific research), low margins of profit maintained permanently and without discrimination, or licenses conferred by, and used within, the limits of law (including patents on one's own inventions, or franchises granted directly to the enterprise by a public authority)." Perhaps, then, so far as efficiency is concerned, *Alcoa* only shifts the burden to the firm to justify its growth. It seems clear that *Alcoa*, in any event, has not settled the question of the weight to be given to the requirements of efficiency. In the enforcement of a regulatory

12 *Id.* at 431.

13 United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 342 (D. Mass. 1953).

statute, this issue might be less troublesome, but it is different for a statute intended to remove restraints to enterprise as a means of fostering competition. For the artificial limitation on the growth of a firm is of as much concern as the artificial growth through combination in order to monopolize. This is a major unsolved problem in the field of antitrust.

Whatever difficulties the doctrine of *Alcoa* may have with the application of the law to growth because of efficiency, the case, since it deals with undoubted monopoly size, has a strong underlying basis for its assumption that this size carries with it the power to fix prices. In the case of the assured monopoly, one may predict a restriction on production because this restriction will be sensible from the standpoint of the firm. To be sure, even then the firm will wish to take into account problems of good will and the threat of governmental intervention. This restriction on production may provide adequate justification for a law which carries the burden of limiting economic expansion. But the application of the monopolizing concept of the law to units of lesser relative size raises special difficulties. For with units of lesser relative size, it cannot be said that there will be inevitably a restriction in production. If it is granted that there will be more competition if additional units are fashioned in the industry, this may not be an adequate basis to justify the application of the law. This is particularly true in terms of both the state of economics and of the history of the Sherman Act. For the Sherman Act, as has often been said, is directed against restraints and monopoly or monopolizing. It was not intended to compel all possible competition. The act arose out of an antipathy towards monopoly, and those restraints which were thought to have the consequences of monopoly. And it is in the identification and the prediction of the consequences of monopoly that economics has been the most to contribute. There is much greater uncertainty about the consequences of imperfect competition. The application of the monopoly concept to industries with three or four large units leads to curious anomalies. Thus what is deemed adequate relief for one industry, as, for example, the three firms in aluminum,[14] may be the starting point for bringing a case against another industry, such as tobacco.[15] It is in connection, with the application of the antitrust laws to firms of less than clear monopoly size, that the concepts of collusion and abuses have been expanded.

THE APPLICATION OF THE MONOPOLY CONCEPT TO INDUSTRIES WITH THREE OR FOUR LARGE UNITS LEADS TO CURIOUS ANOMALIES. THUS WHAT IS DEEMED ADEQUATE RELIEF FOR ONE INDUSTRY MAY BE THE STARTING POINT FOR BRINGING A CASE AGAINST ANOTHER INDUSTRY.

14 United States v. Aluminum Co. of America, 91 F. Supp. 333 (S.D.N.Y. 1950).

15 American Tobacco Co. v. United States, 328 U.S. 781 (1946).

Perhaps it can be said that what is emerging is a law limiting the uses of size. As Justice Holmes wrote in his dissent in *Northern Securities*, "it has occurred to me that it might be that when a combination reached a certain size it might have attributed to it more of the character of a monopoly merely by virtue of its size than would be attributed to a smaller one."[16] But since the units themselves do not have that position which would justify condemning them as monopolies, instead the law has developed to prohibit for them certain types of conduct deemed collusive or abusive. Thus without a finding of monopoly, collaborative efforts accompanied by the exclusion of others for competitive reasons are deemed unlawful in the *Associated Press* case;[17] vertical integration becomes unlawful in the motion picture industry,[18] although vertical integration per se is not illegal; tying arrangements are found illegal when based upon what is called a monopoly or dominant position, although the position in itself may be deemed lawful.[19] This places the concepts of collusion and abuses in a new light.

The concept of abuses is illustrated in Justice Douglas' opinion in *United States v. Griffith*.[20] The *Griffith* case is one of a sequence of antitrust cases dealing with the motion picture industry. In *Griffith*, affiliated exhibitors used a common agent or agents to negotiate with distributors. The exhibitors therefore "were concededly using their circuit buying power to obtain films." Moreover, "their closed towns were linked with their competitive towns." These practices apparently were decisive in finding a conspiracy in violation of both section one and section two of the Sherman Act. Justice Douglas explains that "anyone who owns and operates the single theatre in a town, or who acquires the exclusive right to exhibit a film, has a monopoly in the popular sense," although it is not necessarily illegal. Then, "if he uses that strategic position to acquire exclusive privileges in a city where he has competitors, he is employing his monopoly power as a trade weapon against his competitors. It may be a feeble, ineffective weapon where he has only one closed or monopoly town. But as those towns increase in number throughout a region, his monopoly power in them may be used with crushing effect on competitors in other places.... When the buying power of the entire circuit is used to negotiate films for his competitive as well as his closed towns, he is using monopoly power to expand his empire." This is "a misuse of monopoly power under the Sherman Act. If monopoly power can be used to beget monopoly, the Act becomes a feeble instrument indeed." There

16 Northern Securities Co. v. United States, 193 U.S. 197, 407 (1904) (dissenting opinion).

17 Associated Press v. United States, 326 U.S. 1 (1945).

18 United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

19 See Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953).

20 334 U.S. 100 (1948).

could be no doubt that the monopoly power of the circuit "had some effect on their competitors and on the growth" of the circuit.[21]

The doctrine of abuses sees them as exclusionary devices useful for getting a monopoly, or expanding it, or for moving from one monopoly to the creation of another. Thus when vertical integration is concerned, the inquiry is often as to the "leverage" of the device. When a tying clause is annexed to a patent, the courts regard this as an attempt to expand the scope of the patent, or as an attempt to create a new monopoly using the leverage of the patent monopoly. So in the *Griffith* case, buying power which joins the competitive with the closed towns, is a use of monopoly power to beget monopoly. It is natural that as the antitrust laws are applied to firms with less than assured monopoly size, new emphasis should be placed upon these exclusionary devices or abuses. Since the firms have not achieved positions which are regarded as illegal in themselves, it becomes important to see if their conduct threatens to bring to them greater monopoly power. The rule of *Griffith*, then, in contrast to *Alcoa* which dealt with assured monopoly size, emphasizes these exclusionary practices which are viewed as the means of achieving greater monopoly power and therefore as an illicit use of the power already possessed.[22] New importance therefore must be attached to the concept of abuses. In addition, the history of related legislation since the Sherman Act is to give independent status to these abuses. The abuses represent conduct which is thought to create monopoly and these are the practices to be caught under the Robinson-Patman Act, under section three and, to some extent, seven of the Clayton Act, and under section five of the Federal Trade Commission Act. The practices are to be caught in order to prevent monopoly in its incipiency.

We are not sure of the basis or the justification for the concept of abuses. Insofar as the practices involved are covered in special legislation, perhaps it may be suggested that all that is involved is a legislative determination that conduct should be banned. These enactments have introduced a certain automaticity into the law; to some extent they preclude or make unnecessary separate inquiry in each of the cases as to the effects, advantages, or disadvantages of the banned practices. But even so the enactments must be supposed to rest upon conclusions drawn from experience and supportable in general, even though they may not be true of an exceptional case. Moreover the interrelationship between the Sherman Act and the amendatory acts suggests that none of the special statutes is completely insulated from a pervasive concern with the doctrines of economics in the field of competition and monopoly. Indeed the attempt to apply the legislative standard with strictness has provoked criticism. The report of the

21 *Id.* at 107-8, 109.

22 See Judge Wyzanski's discussion of the *Griffith* case in United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 342 (D. Mass. 1953).

Attorney General's Committee on section three of the Clayton Act, relating to exclusive dealing, for example, seems to prefer "full factual analysis of significant market data,"[23] and here as elsewhere it appears to favor incorporation of advances in economic teaching into the case law.[24] We may conclude that to an undefined extent it is of interest to the law to know whether the abuses in fact do create monopoly.

The economic teaching gives little support to the idea that the abuses create or extend monopoly. Firms that are competitive cannot impose coercive restrictions on their suppliers or their customers as a means of obtaining a monopoly. They lack the power to do this effectively. Firms which have some monopoly power over prices and output can impose coercive restrictions on suppliers and customers. In the normal case, however, they will lose revenue if they do impose such restrictions, and this casts some doubt on how prevalent or continued the practice would be. Such firms would lose revenue because they cannot both obtain the advantage of the original power and impose additional coercive restrictions so as to increase their monopoly power. The coercive restrictions on customers are possible only if the price which would be charged without the restriction is reduced. The restrictions therefore would not be sensible except as a means of price discrimination. If used as a means of price discrimination, the restrictions might be considered more an enjoyment of the original power than an extension of it. In point of fact even a firm with complete monopoly power over prices and output cannot both get the advantage of such power and impose additional coercive restrictions on suppliers and customers. At most such a firm, and of course one with only some monopoly power, can decide to impose additional costs upon itself for the sake of a restriction. Such a restriction might be valuable if the effect of it would be to impose greater costs on possible competitors. But except for this special case, there is no clearly apparent advantage to a firm with monopoly power as against one without such power.

In point of fact even a firm with complete monopoly power over prices and output cannot both get the advantage of such power and impose additional coercive restrictions on suppliers and customers.

We realize that it is sometimes said that the restrictive practices support or extend monopolies because they can impose large capital requirements on existing or potential competitors. But this argument seems to require clarification and study. It is not evident whether the argument is based on an imperfection in the

23 Report of the Attorney General's National Committee to Study the Antitrust Laws 143 (1955). The phrase is used in describing the Commission's handling of the Anchor Serum Co., F.T.C. Dkt. No. 5965 (Feb. 16, 1954), *aff'd*, 217 F.2d 867 (7th Cir. 1954), and Harley-Davidson Motor Co., F.T.C. Dkt. No. 5698 (July 7, 1954).

24 See Report of the Attorney General's National Committee to Study the Antitrust Laws 132 (1955).

capital market, on the reluctance to assume the consequent risks, on the economies associated with raising large amounts of capital, or on the less efficient scale imposed on rival firms.

To a certain extent the economic analysis of the effect of the abuses may be relevant only to an interpretation of the meaning of the language of the law. We have suggested that in most instances the supposed abuses neither support nor enlarge monopoly power. Yet we realize that in the typical patent tying clause case, for example, the courts speak of the device as an attempt to expand the patent monopoly. In the *Carbice* case,[25] for example, where the patent was "for a particular kind of package employing solid carbon dioxide in a new combination," but not on the package nor on the dry-ice, the use of the patented combination was tied to the purchase of dry-ice. Justice Brandeis stated that "relief is denied because the Dry Ice Corporation is attempting, without sanction of law, to employ the patent to secure a limited monopoly of unpatented material used in applying the invention." This was beyond the "scope of the patentee's monopoly." In the *Mercoid* case, [26] the use of a combination patent on a heating system was tied to the purchase of stoker switches used in the combination. Justice Douglas stated that the case was "a graphic illustration of the evils of an expansion of the patent monopoly by private engagements." The practice in both of these cases could be described as an administrative device for collecting revenue from patents assumed to be valid.

The *Carbice* and *Mercoid* cases are perhaps exceptional in the tying clause field because they involve combination patents. The usual reference in this area would be to the practices as portrayed in the *Dick*,[27] International Business Machines Corporation,[28] *and the block booking portions of the motion picture cases*.[29] In the *Dick* case the use of the mimeograph machine was tied to the purchase of the supplies for it. The restriction was impliedly upheld, but Chief Justice White in dissenting wrote, "I have already indicated how, since the decision in the Button Fastener Case, the attempt to increase the scope of the monopoly granted by a patent has become common by resorting to the devices of license restrictions manifested in various forms, all of which tend to increase monopoly and to burden the public in the exercise of their common rights. My mind cannot shake off the dread of the vast extension of such practices which must come from the

25 Carbice Corp. v. American Patents Development Corp., 283 U.S. 27, 30, 33 (1931).

26 Mercoid Corp. v. Mid-Continent Inv. Co. 320 U.S. 661, 666 (1944).

27 Henry v. Dick Co., 224 U.S. 1 (1911).

28 International Business Mach. Corp. v. United States, 298 U.S. 131 (1936).

29 United States v. Paramount Pictures, Inc., 334 U.S. 131, 156 (1948).

decision of the court now rendered."[30] In the *International Business Machines* case, the use of the machines was tied to the cards utilized with it. Justice Stone characterized the effect of the condition as one "whose substantial benefit to the lessor is the elimination of business competition and the creation of monopoly. . . ."[31] Block booking is described in the *Paramount* case as the "practice of licensing, or offering for license, one feature or group of features on condition that the exhibitor will also license another feature or group of features released by the distributors during a given period."[32] The result was said "to add to the monopoly of the copyright in violation of the principle of the patent cases involving tying clauses." Nevertheless, we believe that the practices in each of the three cases can be explained best as methods of charging different prices to different customers and not as extensions of monopoly to other areas.

THE PRACTICES IN EACH OF THE THREE CASES CAN BE EXPLAINED BEST AS METHODS OF CHARGING DIFFERENT PRICES TO DIFFERENT CUSTOMERS AND NOT AS EXTENSIONS OF MONOPOLY TO OTHER AREAS.

There are three remaining types of restrictive practices to which reference is frequently made. They are: (1) joint buying power linking open and closed situations as in the *Griffith* case; (2) exclusive arrangements as in the *Standard Fashion*[33] *or* Standard Oil of California *cases;*[34] and, (3) vertical integration. The joint buying power arrangement assumed to exist in *Griffith* includes within that power the strength of the monopoly of the theatres in the closed towns. This monopoly by itself is assumed to be lawful. If it is a monopoly, the owner will be enabled to obtain better prices from the suppliers than could be obtained by each of several independent exhibitors in that market. As we have suggested, it would seem that in order to impose additional coercive restrictions on the suppliers, as, for example, on the supplies for competitive markets, the monopoly owner would have to pay the suppliers for these additional restrictions. Nor would it seem to be in the interest of the suppliers to encourage the growth of monopoly among the exhibitors. Perhaps it could be argued and shown that monopoly of the theatres confers larger resources upon the owner, but otherwise the monopolist has no obvious advantage for competitive areas over any other competitor who sets out to establish a monopoly. It would seem therefore that

30 224 U.S. 1, 70 (1912).

31 298 U.S. 131, 140 (1936).

32 334 U.S. 131, 156, 158 (1948).

33 Standard Fashion Co. v. Magrabe-Houston Co., 258 U.S. 346 (1922).

34 Standard Oil of Calif. v. United States, 337 U.S. 293 (1949).

the method of buying supplies for a monopoly and a competitive market through a single course cannot be assumed to be effective as a means for extending a monopoly without additional evidence. There is no necessary effect on competitors. The case is not necessarily different from where the single source buys for many competitive theatres.

In the exclusive arrangement cases, the firm which is assumed to have some monopoly power imposes a cost upon itself in order to obtain the restriction forbidding its customer from handling the goods of others. There is an obvious monopoly problem if control over all the possible outlets were thus obtained, but most of the cases do not involve such control, nor would it be clear that firm with a monopoly over the supply would wish to obtain a monopoly over the outlets. Its monopoly over the supplies is not increased through its monopoly over the outlets, unless it can be said that the restrictions on the outlets impose greater costs on potential competitors than they do on the monopoly company itself. This may have been the situation in the *Standard Fashion* case. There a firm with widespread control over a variety of patterns for garments entered into exclusive arrangements with a multitude of outlets. A competitor with less control over the variety of patterns might, through this arrangement, have a greater cost imposes upon it to secure outlets. The reason for this is that there may well be economies for an outlet in handling a variety of patterns. But the *Standard Oil of California* case seems less justified on this basis. In that case no one firm had such a dominion over the products, and a single outlet handling the gasoline of a competitor would appear to have the same economies open to it as were open to Standard's stations. The vertical integration cases appear similar to the exclusive arrangement situations. Vertical integration, however, often appears explainable as a method of price discrimination. It will be said that vertical integration like exclusive arrangements and tying clauses increases a competitor's capital requirements, and so places him at a disadvantage. We have already indicated our belief in the need for further exploration and clarification of that line of argument.

If, then, there is doubt as to the economic support for the conclusions of law with respect to the effect of abuses, this does not mean the law will change. When the courts speak of expanding a monopoly, or of attempting to secure a monopoly through various exclusionary means, the language used may point to matters about which economics has little to say. For example, the scope of the monopoly conferred by a patent is a matter of law. Perhaps a combination patent cannot be enjoyed if the only means of collecting for its use is through the sale of one of the parts. Perhaps, also, the enjoyment of a patent is to be cut short to prevent price discrimination through the use of a tying device. Having conferred a monopoly in one area, the courts may feel that the incidents of that monopoly must be confined. Thus a restriction imposed on the use of products with a patented machine would have an effect upon the producers of the products. Moreover, even if the restriction does not bring a new monopoly into existence, it can be regarded as a restraint. The important point, however, is that the restrictions or abuses will not in most cases carry with them the normal incidents of monopoly. They will not in the normal case carry with them any decrease in production, nor, except for price discrimination, any increase in revenue, nor any increase in price. They may in fact, in some cases of price discrimination, result in an increase in production. In the language of the Robinson-Patman Act and of the Clayton Act, the abuses do not in most cases either tend to substantially lessen competition or tend to create a monopoly. If this were agreed upon, the law might not change, but its objectives would be clarified. The law would be seen as having less to do with competition and monopoly and more to do with merely a set of rules of fair conduct, perhaps emphasizing the protection of smaller firms. Clarification of the economic basis thus presents the opportunity of choice for the law.

THE RESTRICTIONS OR ABUSES WILL NOT IN MOST CASES CARRY WITH THEM THE NORMAL INCIDENTS OF MONOPOLY. THEY WILL NOT IN THE NORMAL CASE CARRY WITH THEM ANY DECREASE IN PRODUCTION, NOR, EXCEPT FOR PRICE DISCRIMINATION, ANY INCREASE IN REVENUE, NOR ANY INCREASE IN PRICE.

The problem of collusion has always been central to the antitrust laws. Price-fixing agreements operate to affect the market price when they result in restriction in output which affect the market supply. It is difficult to provide an economic basis for a law against price-fixing agreements when the market price is unaffected. Moreover, price-fixing agreements, when adherence to them cannot be compelled through coercion or penalties, might be self-correcting either through the defection of members, which would be rewarding to the individual firm, or through the advent of new firms. But if a price-fixing agreement occurs between members of an industry controlling a substantial share of the market, then, when seen as in reality an agreement to control output, the consequences of this behavior may be predicted with some certainty. It becomes unnecessary to examine the consequences in the individual case in order to determine whether the resulting prices are different than competitive. Adopting the standard of competition, it becomes unnecessary to embark on what Judge Taft called a sea of doubt where reasonableness of the prices is in issue.[35] Accordingly, there is an economic foundation for the illegality of price fixing in itself when market price is affected. There is less foundation when it cannot be shown that the members of the arrangement control a substantial share of the market. And despite the repetition of the slogan that price fixing is illegal per se, the cases as yet do not hold, save possibly for resale price control, that price-fixing agreements without

35 United States v. Addyston Pipe and Steel Co., 85 Fed. 271, 284 (6th Cir. 1898).

power to affect the market price are illegal.[36] The clarification which economics can contribute at this point is to emphasize the importance of examining the effect of the agreement on production and the market supply. Yet surely the law may conclude on its own that if the participants believe the arrangement to be worthwhile for them, then there is sufficient likelihood market supply is affected so that a general prohibition is justified. The extension of the Sherman Act into the remoter nooks and crannies of commerce, because of the broadened view of commerce among the states, however, may be thought to raise some question as to the worthwhileness of a prohibition of all forms of price fixing regardless of market effect.

> Despite the repetition of the slogan that price fixing is illegal per se, the cases as yet do not hold, save possibly for resale price control, that price-fixing agreements without power to affect the market price are illegal.

But the serious problem of collusion is to determine what conduct is to be characterized as the equivalent of an agreement to control output.[37] A facet of this problem concerns allowable trade association activities and the proper scope to be permitted to the uses of knowledge. The relative merits of knowledge and ignorance are not well defined in legal or economic doctrine. The counterpart of efficient scale in the size problem is the improvement of the market where collusion is concerned. Behavior designed to achieve these improvements cannot be readily isolated from behavior which can be interpreted as characterizing monopoly or effective agreements to control output. For example, dissemination of real or assumed knowledge as to pending market changes can bring about a restriction in output in the industry. The magnitude of the change for the individual firm, however, must be based on a prediction by that firm of the behavior of other firms in the industry. It would appear to be extremely difficult and unwise for the law to assume that action taken on general knowledge implies a concert of action

36 The opinion in United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940), whittles away at the notion that a price-fixing agreement is illegal only if the group in it has the power to affect the market price. In the famous footnote 59 of that opinion Justice Douglas reminds us that "a person 'may be guilty of conspiring, although incapable of committing the objectionable offense'." The thrust of footnote 59 is not entirely clear, for in part it reads as though *control* of the market price, which is not required, were being distinguished from an *influence* upon it of advantage to the members of the combination. In this respect the footnote echoes the language of the body of the opinion that it was immaterial "that other factors also may have contributed to that rise and stability of the markets." *Id.* at 219. We have Judge Hand's interpretation of the footnote to the effect that the plan would be unlawful "even if the parties did not have the power to fix prices, provided that they intended to do so." United States v. Aluminum Co. of America, 148 F.2d 416, 432 (1945). But footnote 59 is dictum, for in the actual case "proof that prices in the Mid-Western area were raised as a result of the activities of the combination was essential . . . in order to establish jurisdiction in the Western District of Wisconsin. 310 U.S. 150 at 224.

37 As, for example, in American Tobacco Co. v. United States, 328 U.S. 781 (1946); FTC v. Cement Institute, 333 U.S. 683 (1948); Theatre Enterprises, Inc. v. Paramount Film Distributing Co., 346 U.S. 537 (1954).

equivalent to collusion, conspiracy or agreement, and yet the result may be the same as that which follows from an agreement. It seems unworkable to suggest that illegality in such cases should be reserved for those instances where the restriction in individual output goes beyond the point justified by a common reaction and reaches that further restriction of output characteristic of a monopoly. This problem concerns also the application of the law to industries with several large firms when the attempt is made to deal with them as jointly monopolizing because of common patterns of behavior. Here it cannot be said that economic doctrine indicates with certainty that there will be collusion among the firms; it cannot be said that there will be inevitably a restriction in production.

The central problems in the field of antitrust as yet unsettled and pressing for solution concern size, abuses and collusion. We do not mean to suggest that there are simple economic or legal answers. The problems are difficult, and the law is not likely to meet them directly. Nor do we mean to suggest that the law must of necessity conform to the prescriptions of economic theory, let alone move within the confines of changing fashions in such theory. The law indeed can have a life of its own. But in this field of law more than any other, the general presumptions are of such a character that they cannot be readily isolated from the corresponding presumptions that in the future there may well be a recognition of the instability of the assumed foundation for some major antitrust doctrines. And this may lead to a re-evaluation of the scope and function of the antitrust laws.