The Ongoing Role of Economics in U.S. Antitrust Law

By Thomas B. Leary*

You have all probably heard or read many speeches on the importance of economic analysis in the resolution of antitrust cases in the U.S., and you may have gained the impression that this analysis is based on a purely objective, almost mathematical process. If this were possible, convergence would mean that decision-makers everywhere would reach the same conclusions about the same set of facts.

My primary purpose is to correct any impression of objective certainty that may exist. Antitrust analysis in the U.S. is indeed "informed" by economics, but well informed people can still reach different conclusions. The analytical process can be a lot more subjective and imprecise in reality than it may have appeared in theory. This was true even before worldwide market collapse last Fall, and the intellectual fallout from that collapse is likely to increase the degree of uncertainty. This paper will here attempt to summarize some well recognized sources of uncertainty, and then speculate about some future developments.

The word "speculate" is chosen deliberately. Change is in the wind, but no outside observer can be sure what form it will take. The new heads of the antitrust agencies in the U.S. have not outlined a comprehensive agenda. Moreover, the mention of various possibilities here should not be taken as either a personal or an official endorsement. Some of the possibilities may be sensible policies; others may not. Absent the factual background of specific cases, it is difficult to endorse specific approaches anyway, and lifelong experience demonstrates that even then

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the policy choices may well turn out to be wrong. Human beings are sometimes frail and always fallible.

I. Present Sources of Uncertainty

I begin on a personal note. For most of my professional life, representing clients in private practice, the inherent difficulties in resolving antitrust cases were not so apparent. Lawyers with their clients know from the start which "side" they are on. It is their job to present the best arguments that they can to support their clients' position, and they do not need to resolve larger policy issues. Service on the U.S. Federal Trade Commission, however, made me aware that these policy choices can sometimes be difficult. It was not always immediately obvious whether the "public interest" would be served by prosecution of a particular case. Lawyers and economists for the government and for a potential target will advocate conflicting positions, with plausible calculations and arguments.

The immense contributions of economists in recent decades have made it possible for all sides to focus their arguments. They have, for example, supplied rational, pro-competitive explanations for conduct that was once condemned out of hand; they have identified the fundamental distinction between "horizontal" and "vertical" restraints; they have offered short-cut tests to distinguish between benign and "predatory" actions; and they have secured near-universal agreement on the proposition that nebulous social and political concerns should not drive antitrust policy.

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As a result of this consensus, antitrust counselors are able to accurately assess antitrust risks for the vast majority of proposed business strategies. Economic precision is not necessary because the balance tilts strongly in one direction or another. Perhaps the best demonstration of this reality can be found in the statistical record of merger challenges in the U.S. Because all mergers above a certain size have to be notified in advance to both the DOJ and the FTC, thousands of transactions are reviewed every year. Detailed statistics are available for almost thirty years that show the number of transactions that were summarily cleared, the number subjected to a more searching review, and the number that were challenged or abandoned. Four Presidential administrations have come and gone during that time, and the record shows that the challenge rate consistently hovers around one percent. 1/ This evidence suggests that most proposed transactions are benign. It also suggests that the agencies and outside commentators have conveyed government intentions with reasonable accuracy, and there have not been excessive public or private resources wasted on problematic transactions.

But the easy cases are not worth much discussion; it is the hard ones that have stimulated controversy in the U.S. and around the world. 2/ It is worthwhile to consider the existing sources of recent controversy in the difficult cases and possible future developments that may be even more controversial.

The fundamental problem is that in virtually all antitrust cases a prosecutor with discretion or an ultimate finder of fact must make predictions. 3/

With the exception of the hard-core per se offenses, where the only issue is who did what, it is necessary to assume what would happen in alternative universes. This is obviously true when a proposed merger or future competitive strategy is under review, but it is also true when past conduct is considered. The actual outcome is known, but that outcome has to be compared with a predicted outcome if the conduct had not occurred.

Economists make these predictions by constructing "models" of the competitive environment. Various alternative models are available for different kinds of industries, but they have common characteristics. In order to reduce the variables in complex situations, it is necessary to make certain assumptions. For example, an economist may assume (a) that competitors seek to maximize their "profits," defined in a particular way; (b) that they will consistently adhere to particular strategies in order to do so; and (c) that price is the most significant variable. With these assumptions in place, and further assuming that consistent data is available, it is possible to make mathematical calculations and "predict" likely price effects with several significant digits. The appearance of precision is, of course, spurious; in the close cases where the analysis really matters other equally talented economists can predict entirely different outcomes simply by modifying the underlying assumptions.

The decision process becomes further complicated when various "defenses" are advanced. In a merger case, for example, parties will usually claim that anticipated efficiencies will offset any assumed price increases that might

result from higher levels of concentration. This defense requires further predictions based on further assumptions. The parties may also claim that new entry will discipline any tendency for prices to increase, which involves yet another set of assumptions and predictions about what other companies will do. And, finally, since even the most sophisticated calculations can only yield probabilities, not certainties, it is not possible to eliminate value judgments entirely. Different people have different tolerances for different kinds of risks, and these views cannot be reconciled by purely rational discourse. Even if the economists all agreed on the magnitude of the various risks and benefits in any particular situation, reasonable people might still draw different bottom-line conclusions.

The inevitable intrusion of value judgments is, of course, not a unique characteristic of antitrust law. It also is a common issue in other areas of public policy, which are also informed by economics. The appropriate balance between prevention of exploitation and preservation of incentives, for example, will be debated endlessly. In fact, the remarkable thing about antitrust, with all the relevant variables, including different statutory commands in different countries, is the level of agreement that we observe across the world. It is appropriate to credit the widespread acceptance of economic principles for this level of convergence, but it is also appropriate to recognize the inherent limitations – even if we assume a relatively stable overall environment. (A recent article on "The Inevitability of Uncertainty," which contains an expanded discussion of this point, is attached as an Appendix.)

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In recent months, faith in future stability and the predictive power of economics has been shaken everywhere. The next section will consider the likely effects of these recent developments on future economic analysis in the antitrust field.

II. Some Future Possibilities

There is a tendency to forget that economics, like all other sciences, is an evolving discipline and particularly spurred by a perception of crisis. William Baxter, once head of the Antitrust Division in the U.S. and one of the godfathers of what was then called the "new learning", said in 1985: 4/

> " . . . a slowly growing body of knowledge of industrial organization . . . is slowly and tortuously leading the legal profession . . . in the direction of a fairly sensible antitrust policy, *a policy based on whatever it is we know at any particular moment about the economics of industrial organization*.

This statement implicitly recognizes that what seems heretical today may be in the mainstream tomorrow. The following speculations should therefore not be taken as a repudiation of antitrust law informed by economics but simply as recognition that human comprehension is always imperfect.

A definitive analysis of recent market events will require a longer perspective than is available now, but it now seems that major contributing causes were an obsessive preoccupation with financial speculation coupled with a systemic inability or unwillingness to take sufficient account of remote market risks – whether remote in time or in probability. If this perception were commonly accepted, what might be the consequences for antitrust?

(a) A Shift in the Burden of Persuasion

At her confirmation last Spring, the incoming head of the Antitrust Division, Christine Varney, spoke of a need to "re-balance" enforcement of the antitrust laws. Although she did not explain what she meant, it is possible she intends to weaken the default assumption that business strategies usually have an underlying efficiency rationale. Successive iterations of the Merger Guidelines in the past have been increasingly receptive to efficiency defenses. The 1982 version said efficiencies would be considered only in "extraordinary cases;" the 1984 version said this formulation was too "restrictive" but still required proof by "clear and convincing evidence;" the 1992 version introduced a sliding scale approach, which required only that the efficiencies be "more significant than the competitive risks identified;" and the 1997 partial revisions significantly expanded the discussion of efficiencies. [5/]

In recent years, a number of economic studies have indicated that a significant number – perhaps a majority – of consummated mergers have failed to produce the predicted efficiencies. If these predicted efficiencies were relied on during the merger review process to offset a likely price increase, it would be a matter of antitrust concern today. Traditional antitrust has not been used, however,

merely to discipline management decisions that only have injured shareholders.

But, this might change. Arguably, the almost frenzied merger activity observed in the U.S. for over twenty years, like other forms of market speculation, represents a vast diversion of talent and energy into non-productive activities, with adverse macro economic effects. Fundamental belief in the economic rationality of business transactions might be weakened. Policy makers who take this view could chill the merger review process by simply tightening the standards for proof of efficiencies or other "defenses.". Antitrust is normally not concerned with macro effects in particular cases, but they do affect global assumptions that color enforcement policies. (For a comparable effect consider hypothetically the impact on intellectual property law if faith in the nexus between the patent system and innovation were weakened.)

(b) "Too Big to Fail"

After the economic collapse and massive bail-outs that occurred last Fall, some commentators in the U.S. suggested that in the future companies should not be allowed to grow "too big to fail." One view would be that this concept reintroduces alien political considerations into an antitrust law that has rejected them for at least thirty years. The decision to lend public support to a U.S. company like Chrysler,

for example, was hardly responsive to a perceived "competitive" concern.

But, there is a variant of the "too big to fail" argument that could be consistent with traditional concerns about the vitality of competition. What it requires is a shift away from the traditional exclusive focus on conduct that makes a company too "strong" and some consideration of conduct that may make a company too "weak," and hence more prone to failure.

The most obvious example would be a highly leveraged merger, or series of mergers, that may impair the surviving company's ability to compete aggressively in normal times and to survive in a period of economic stress. Absent a significant horizontal overlap, leveraged buyouts have not been treated as an antitrust issue, but that also could change. A concurring opinion that accompanied the FTC complaint in the Ovation [6/] case last year specifically raised the possibility of an antitrust attack on a pure conglomerate transaction (albeit in a different factual context). This opinion was endorsed by two out of the four present FTC Commissioners, who may be joined later this year by one or two new colleagues with equally expansionist views.

Other variants of the "too big to fail" argument might result in heightened concern about mergers at lower levels of concentration,

greater emphasis on the preservation of particularly aggressive "maverick" competitors, and more stringent standards of proof for an "entry" defense. Outside the merger area, a perceived need for diversity of competitors with different competitive strategies might lead to stricter scrutiny of conduct that increases barriers to the entry or growth of companies that are thought to be innovative. That could involve some relaxation of the present tendency to define "predation" narrowly as conduct that impairs the viability of an "equally efficient" competitor. (Although it may be difficult to identify the currently less-efficient competitors with sufficient promise to merit protection.)

(c) Control of Unilateral Conduct

Some of the differences between the U.S. and the EU approaches to unilateral conduct are based on differences in their governing statutes. The reference to "abuse . . . of a dominant position" in Article 82 of the EU Treaty invites scrutiny of the behavior of a present monopolist, the use of the word "monopolize" in Section 2 of the Sherman Act invites scrutiny of the process by which a monopolist obtained or maintained its monopoly position in the first place. This means that in the U.S. the focus is on so-called "predatory" behavior directed against present or would-be competitors, even though consumers may actually benefit in the short run. Monopolists are not condemned in the U.S. if they simply charge monopoly prices, for

example, even though consumers are the supposed beneficiaries of U.S. antitrust policy.

In part, this may reflect an economic consensus that cost-plus regulation of existing monopolies chills efficiencies and harms consumers in the long run. It may also reflect a common perception that the attempt to secure some measure of market power is what really drives competition in the modern world, and that the ability to command supra-competitive prices is an appropriate reward for those companies that have won the battle according to the rules of engagement. [7/]

Suppose, however, that some companies have gained a commanding position with the aid of massive government subsidies, as part of a general effort to stimulate the economy. These survivors may not be accorded the same respect. They may be treated more like the public utilities, which once were government-regulated monopolies and which are still subject to restrictions of various kinds (principally by individual States) even after general de-regulation throughout the U.S. These companies did not "earn" their favored position in the same way as survivors in the rough-and-tumble competitive arena.

What we may see, as a consequence, is a U.S. attitude that moves somewhat closer to the attitude that prevails in the EU today –

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even as the EU seems to be moving closer to the U.S. in some other respects. Policies that protect new entrants who have not yet achieved an efficient scale (mentioned in sub-section (b) above) might also be justified if companies that posses market power as a result of government actions are deemed less worthy.

(d) Growing Complexity and Doubts About Economic Rationality

Even before last year's economic collapse, it was evident that calculations and predictions about price or output cannot adequately capture the complexities of competition. In significant and growing areas of the economy, price is not the most important competitive variable. Great varieties of differentiated products, services and experiences compete in ways that are very difficult to model. [8/]

In addition, existing models are based on the assumption that companies, however large, are motivated to maximize economic profits, and continuously adjust prices and/or output in order to do so. But, company decisions are made by real people, who inevitably have their own individual motivations that may or may not coincide with the company's overall welfare. Decision makers may also have imperfect information about critical variables. These "agency" or "information" issues have been recognized for a long time, but we do not yet have the economic tools to deal with these issues in a systematic way.

Even if management and corporate issues were well aligned, and the necessary economic data were available, there can be other pressures that affect management responses. Considerations like labor relations, customer relations, shareholder relations, or local politics may inhibit the continuous adjustments that economic models might predict. This could suggest that management may adhere to "steady state" or conservative policies rather than more disruptive measures that maximize current profits.

Managers also are affected by currently fashionable strategies in the business world. The fad for diversification (along with then prevalent antitrust constraints) fueled the growth of conglomerate enterprises in the 1960s – enterprises that either disappeared or were broken in pieces when it later became fashionable for companies to focus on their core competencies. The fad for Japanese management principles came and went, as the Japanese economy waxed and waned. The merger wave of the 1980s, and the much larger one in the late 1990s, seemed to stimulate a lot of "defensive" mergers in the U.S., prompted by a perceived need to acquire a target before a competitor does. This herd mentality may also be prompted by managers' desire to be in the mainstream but, as we have recently seen, the herd may sometimes stampede over a cliff.

Finally, recent economic developments may stimulate greater interest in so-called "behavioral economics." Various controlled studies seem to demonstrate that individuals do not maximize their economic welfare in ways that are predicted by theory. For example, people seem to weigh risks and rewards very differently, and actually perversely, depending on whether markets are trending up or trending down. If these apparent anomalies also accurately describe the behavior of large organizations, it would tend to undercut the fundamental assumption of economic rationality that informs antitrust policy today throughout the world.

There is no indication that this profound state of agnosticism about economics will drive antitrust policy in the U.S. – yet. Regardless of what economists think or antitrust prosecutors may want to do, antitrust policy in the U.S. is ultimately determined by judges – or, rarely, by legislators. In recent years, U.S. courts have often rejected innovative theories [9/] and the antitrust agencies are therefore likely to move cautiously on the short run. In the long term, a lot may depend on factors that have nothing to do with antitrust policy. Faith in the economic roots of antitrust will be affected by whether and when the U.S. recovers from the current downturn. In addition, the application of antitrust in specific sectors of the economy

will depend on the fate of currently pending proposals for dramatic change in government regulation of health care or energy.

Conclusion

This dreary recitation of present and future uncertainties about the application of economic principles to antitrust does not mean that economics is unimportant. Economic learning has made significant contributions to sensible antitrust administration in the U.S., and that will continue. However, a lot of work remains to be done. The history of science suggests that periods of conflict and crisis can yield an explosion of new insights. That may well happen in the area of antitrust economics.

I believe that antitrust in the U.S. should continue to be informed by "whatever it is we know at any particular moment about the economics of industrial organization." I also suspect, however, that we all will have to be a little more modest when we state our conclusions.

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[1]/ Comprehensive data on merger reviews are provided in Thomas Leary, The Essential Stability of Merger Policy in the United States, 70 ABA Antitrust L.J. 105 (2002). Also *available at* http://www.ftc.gov/speeches/leary.shtm.

[2]/ Perhaps the most visible controversy involved the differing views of the U.S. Department of Justice and the European Union in the proposed General Electric/Honeywell transaction. See Thomas B. Leary, A Comment on Merger Enforcement In the United States and in the European Union. Prepared remarks before the Transatlantic Business Dialogue Principals Meeting, Washington, DC, October 11, 2001, *available at* http://www.ftc.gov/speeches/leary.shtm.

[3]/ For a further discussion of these issues, see Thomas Leary, The Bipartisan Legacy. Written version of a speech delivered at the American Antitrust Institute's Sixth Annual conference at the National Press Club in Washington, D.C. on June 21, 2005, *available at* http://www.ftc.gov/speeches/leary.shtm.

[4]/ For the source of this quotation, see Essential Stability article, supra n. 1, at 114.

[5]/ For a more detailed review of the various Guidelines changes, see Essential Stability article, supra n.1, at 116-21.

[6]/ FTC v. Ovation Pharms. Inc., FTC File No. 0810156 (Dec. 16, 2008) (Concurring Statement of Commissioner Thomas Rosch), *available at* http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf.

[7]/ See Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398,407 (2004) ("The opportunity to charge monopoly prices – at least for a short period . . . induces risk taking that produces innovation and economic growth."); see also Comment, supra n.2 at 12.

[8]/ For an extended discussion of the "variety" issue, see Thomas Leary, The Significance of Variety in Antitrust Analysis, 68 Antitrust L.J. 1007 (2001). Also *available at* http://www.ftc.gov/speeches/leary.shtm.

[9]/ See, *e.g.*, Rambus Inc. v. FTC, 522 F.3d 456 (D.C. Cir. 2008), *cert. denied*, 129 S. Ct. 1918 (2009) (claimed deception of standard-setting body); Schering-Plough Corp. v. FTC, 401 F.3d 1056 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 2929 (2006) (payment by patent holder to settle litigation).

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APPENDIX

The Inevitability of Uncertainty

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The inevitability of uncertainty

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Introduction

The overall theme of this programme is the ongoing influence of so-called 'Chicago' economics, and the contrasts between the economic approaches of the enforcement agencies in the United States and the European Union. Other speakers will elaborate on apparent differences between the principles applied on opposite sides of the Atlantic, and these apparent differences obviously may trouble antitrust counsellors. This paper will suggest that common agreement on principles or on actual language will not necessarily lead to common outcomes in any particular case, even in a single jurisdiction; that counsellors for global companies will therefore always have to deal with some uncertainty; but that this kind of uncertainty is not unlike uncertainties they have faced in the past.

At the outset, it is important to understand that Chicago economics still dominates antitrust analysis in the United States. People tend to forget what the antitrust world was like roughly 30 years ago, when what was then called 'The New Learning' first became widely known outside the academy.[1] The idea that antitrust policy should be driven by the economics of consumer welfare was considered heretical by many commentators. Similarly shocking was the idea that company size could be associated with desirable efficiencies rather than pernicious 'competitive advantage', the idea that the intensity of competition is not necessarily correlated inversely with levels of concentration, and the idea that vertical restrictions could be pro-consumer.[2]

All of these once revolutionary ideas are now accepted by virtually all antitrust commentators. The big battle is over, and '[w]e play the antitrust game between the forty-yard lines today'.[3] But, the game does go on, in the United States and around the world. Even though there may be common agreement on methodology, there still can be serious disagreement about the appropriate disposition of individual cases. The persistence of these differences, despite common agreement on methods, is something that judges and agency heads need to understand and that corporate counsellors need to deal with every day. It is important for organisations like the IBA to promote harmony between the approaches in the United States and the approaches in the European Union, but it is also important to have realistic expectations.

People think in pictures, and therefore it may be helpful to illustrate the intellectual evolution of antitrust by recalling the works of three famous 20th-century painters. Before the mid-1970s, a lot of business practices were simply declared *per se* illegal because no one seemed able to articulate a pro-competitive explanation. Outside the *per se* area, the rule-of-reason analysis lacked coherent structure. Myriad economic and social factors could be received into the record, without any guidance on how they should be weighed.[4] The finder of fact was somehow supposed to balance the factors in this formless mess. It was rather like the search for a pattern in a painting by Jackson Pollock.

Then came 'The New Learning' or 'Chicago' revolution. The arguments were compelling and elegant, and it seemed like there was at last a rigorous way to separate pro-competitive and anti-competitive behaviour. As Robert Bork explained in his famous treatise, a finder of fact must make a binary determination whether particular conduct was explained by 'the desire to drive out rivals by improper tactics (which is unlikely) or the desire to create efficiency'.[5] This clear articulation, combined with a structured approach to rule-of-reason analysis,[6] gave rise to an expectation that it would be possible to distinguish clearly between conduct that is inside the lines or outside. Rather like a painting by Piet Mondrian.

Today, we recognise that things are sometimes not quite so easy. (The problem was not that Chicago theorists promised too much, but rather that we practitioners expected too much.) It is true that, in addition to the traditional category of offers that are per se illegal, there is a recognised category of business practices that are, in effect, *per se* legal. Antitrust counsellors can clear many practices today that once were suspect, and judges or agency heads seldom have to deal with them. The effects of other practices may be genuinely ambiguous, however, and Chicago economics does not always provide a rigorous way to draw the line. In other words there are broad areas of bright clarity with some fuzziness at the edges. Like a painting by Mark Rothko.

This paper will explain, first, why we are living in a Rothko world and why there really is no way out of it.

Persistent sources of uncertainty

The Chicago revolution substituted a single lodestar, namely the economic welfare of consumers, for the diffused populist objectives that had previously informed antitrust policy and it supplied an analytical framework for determining these welfare effects. But, this did not mean that cases would necessarily be easier to decide or to handicap. Quite the contrary. To the extent that Chicago theorists questioned the inverse correlation between industry concentration and competitive vigour, or supplied likely efficiency justifications for restraints that had previously been deemed *per se* illegal, the outcome of individual cases may actually have become less predictable. The impact of this uncertainty on corporate counselling will be addressed later; the point here is that common agreement on the appropriate logical approach by various antitrust tribunals does not necessarily mean that there will be agreement on the ultimate outcome. To use a crude analogy, even if the appropriate algebraic equations were universally accepted, different experts might still plug in different numbers.

The need to make predictions

The first, and probably most compelling, reason for this state of uncertainty is that virtually all antitrust analysis involves predictions. This is obviously true when it is necessary to evaluate the future competitive effects of a pre-notified merger or of a competitive strategy that has just been announced. Predictions are also required, however, when analysing the competitive effects of past conduct. In this case, of course, there will be evidence of what has already happened in the marketplace, but it is still necessary to weigh this outcome against a prediction of what would have occurred in an alternative universe without the conduct. There simply is no rigorous way to make predictions about matters that depend so much on human behaviour. Economics is not physics.

The economics profession has, of course, developed ever more sophisticated measurements and models, to help people make predictions. These models can provide directional signals, but anyone with experience in the business world knows that the most sophisticated models cannot replicate the complexity of a competitive marketplace, or even a single organisation in the marketplace. Companies are not going to replace CEOs with supercomputers any time soon, and antitrust enforcers or counsellors cannot rely on supercomputers either.

Factors that are hard to quantify

This difficulty is compounded by the fact that matters of competitive significance often cannot be readily characterised or quantified. For example, antitrust law draws sharp distinctions between unilateral and concerted conduct, and it is not always easy to draw the line. In addition, only a small and relatively shrinking segment of US industry deals with fungible products, where comparative prices and output can be fully expressed in numerical terms. A larger and growing segment of US industry deals with combinations of differentiated products, services and experiences, where comparative prices and outputs cannot be readily captured by statistics.

One short opinion that illustrates both problems was written by one of the most eloquent spokesmen for Chicago economics on the federal bench, *Chicago Professional Sports Ltd v National Basketball Ass'n.*[7] The case involved an antitrust challenge to a league rule that would limit the number of basketball games that TV 'superstations' may carry. Judge Easterbrook stripped the case down to two dispositive issues. First, was the league acting as a 'single entity' when it established the rule, and hence immune under *Copperweld.*[8] A second critical issue was whether the limitation on the number of games on these TV stations could be said to 'reduce output'.

On the characterisation issue, the court deferred to the district court's conclusion that the league was acting more like a joint venture than a single entity, but acknowledged that '[c]haracterisation is a creative rather than exact endeavour' – 961 F 2d at 672. In a later opinion in the same case,[9] Judge Easterbrook reiterated that this is a 'tough question', and went on to say that the league might be considered a single entity in some contexts and a joint venture in others.

The 'output' issue was similarly ambiguous. How do you quantify the 'output' of those enterprises that provide consumers with the experience of viewing a basketball game, both live and on TV? The first opinion cited Supreme Court precedent for measuring output by the number of games that the league rule permitted to be broadcast. But, the opinion also implicitly acknowledged that it would not necessarily be inappropriate to adopt other measures of output like, for example, the total number of people who will enjoy the experience, either live or on TV, or perhaps the effect on overall revenues.[10] In fact, the enhanced revenues may indicate that various league rules, designed to benefit the weaker teams, have resulted in closer and more exciting contests, which consumers and advertisers deem a superior experience – and hence could be said to increase 'output'. Again,

however, dedicated supporters of Chicago economics can arrive at different conclusions.[11]

Consider also the example, already cited,[12] of an initial market-power test to provide structure for the rule-of-reason analysis. In many, probably most, cases it is easy to decide that a defendant accused of a restrictive practice does not have market power, if it has a relatively low market share. But, in order to determine the market share, it is necessary to say what the 'market' is, and this can be a complex and controversial task. The economic test for defining a market that is set out in the US Merger Guidelines [13] requires a prediction of whether a 'hypothetical' monopolist in the product and geographic space under consideration could profitably impose a 'small but significant and nontransitory increase in price' – the so-called 'SSNIP' test, over which serious battles have been fought in the international arena. It probably is the best test currently available, but still involves estimates and predictions. Reasonable Chicago-trained minds can therefore arrive at different conclusions.

The attempt to quantify efficiencies

The same problems arise when it comes to measuring the impact of a transaction on efficiencies. A primary contribution of the Chicago revolution was the recognition that efficiencies are important. This is something that is relatively easy to describe, or even illustrate with examples, but actual measurement can be a complex and controversial exercise. The most important sources of efficiency may not be the savings associated with greater scale and scope, but rather intangible improvements in the morale of an organisation that are difficult to quantify and impossible to model. Thus, hard as it is to quantify efficiencies, it is much much harder to predict that efficiencies will actually be realised. A lot of carefully-planned mergers and business strategies fail.

Consider the common example of efficiencies associated with extensive local sales efforts, which provide consumers with amenities like convenient locations, pleasant showrooms with a wide variety of choices, and knowledgeable salespeople. These amenities are expensive and retailers that provide them are vulnerable to 'free-riding' by discount retailers that can close the sale once consumers have been educated about their choices in comfortable surroundings elsewhere. Identification of the role that vertical restrictions play in the containment of free-riding has been a major contribution of Chicago theory, and it is now almost universally recognised that these restrictions should be judged under the rule of reason. This victory alone will not eliminate all controversy, however, because it would be extraordinarily difficult actually to balance any adverse effects of the restriction against any adverse effects of the free-riding,[14] and most courts do not even try. Market-power screens – or simple assertions that intermodal competition is more important than intramodal competition – are commonly applied instead, but the results can still be indeterminate if the market power issue is not clear-cut and/or the risks of free-riding do not appear substantial.

The elusive goal of convergence

What all this means is that even a common agreement on the analytic principles of Chicago economics will not ensure that the antitrust authorities in the United States and the European Union will take the same bottom-line view in any particular situation. In fact, the authorities could issue a joint set of guidelines that conformed, word for word, and still draw different ultimate conclusions.[15] This observation is not intended to denigrate the efforts of the IBA or any other commentators that seek to close perceived gaps between competition law principles applied in the United States and those applied in the European Union. The message simply is that we should not expect too much too soon. Convergence is a laudable goal but will always remain elusive.

Consider just one illustrative example. The IBA comments on the recently published *Discussion Paper on Article 82 of the EU Treaty* recommend specific language to make it clear that the conduct of both dominant and non-dominant companies should not be deemed abusive if it 'is likely to produce ("pro-competitive") consumer welfare enhancing effects that outweigh any ("anti-competitive") market distorting effects'.[16] Assume this recommendation were implemented *verbatim*. There may be near-universal agreement on how to strike the balance in some cases but, for the reasons stated, there will be other cases in which even the most dedicated Chicago economists would disagree.

Identical outcomes are not assured with identical words, even at the federal agencies' level, and possible outcomes are even more variable when the vagaries of private litigation in the United States – and, perhaps, some day in the European Union – are taken into account. This is a big issue, worth extended treatment all by itself, and something that no corporate counsellor can ignore. The risk of private litigation before potentially hostile juries means that corporate counsellors in the United States have never been able to rely solely on the standards for decision outlined in US federal cases and the writings of US federal

enforcers. They have had to accommodate uncertainty for a long time.

Some practical approaches to uncertainty

A little history may be instructive. In the early 1980s, the Chicago approach was still highly controversial, the federal agencies were out in front of some courts, and academic opinion was still divided. Some believed that the evolving standards complicated the job of corporate antitrust advisers. I then expressed a contrary view.

" Some have complained that rapid evolution, with a possibility of reverter, leads to unpredictability and inhibits antitrust compliance. This is true only if a client is determined to walk close to the cliff edge. The conservative advice of a decade ago is still valid today; in fact, the chances of an antitrust attack against long-standing business practices are considerably reduced. It is therefore easier than ever before for a lawyer to say 'yes'; it may sometimes be more difficult to say 'no'. This is so, of course, because the 'rule of reason' had replaced flat *per se* prohibitions in a number of areas."[17]

The situation today is in many ways similar. Despite some apparent differences between the approaches of US and EU competition authorities, there obviously has been movement toward greater convergence. The recent *Discussion Paper on the Application of Article 82 to Exclusionary Abuses* is an extraordinarily ambitious attempt to restate the law in this broad area. There are some comments that observers on this side of the water may think are inconsistent or at variance with EU authority, but that is not unusual when agencies are attempting to find their way in a changing environment. For a domestic example, compare the way that concentration has been discussed in successive iterations of the US Horizontal Guidelines, and consider the still lingering inconsistency in the latest version – which refers to a market share 'presumption' in section 1.51(c) but goes on to state in section 2.0 that concentration data provide 'only the starting point' for the analysis.[18] (Experienced counsellors in the United States understand that the latter statement is more likely to be operative, unless concentration levels will be very high.)

Perhaps, the most significant thing about the discussion paper is the fact that it relies so extensively on economic reasoning of a kind that is familiar to practitioners in the United States. The paper does not widen gaps, it narrows them. Counsellors who advise multinational clients can survive in this evolving environment just as they did in the comparable environment that existed in the United States some 20 years ago. Now, as then, counsellors need to be realistic, flexible and creative.

Those who are not responsible for day-to-day antitrust advice may not appreciate that corporate counsellors frequently have to provide a fast response. Assessment of the legal risks involved in aggressive pricing programmes, or vertical restraints, or even pursuit of an acquisition opportunity, usually cannot await a full file search, canvass of customers, and economic analysis of the possible competitive effects. To the extent that these matters are governed by the rule-of-reason – which is what Chicago analysis is mostly all about – counsellors and their clients have to manage uncertainty.

In these circumstances, it is useful – indeed, imperative – for counsellors to advise clients on the hierarchy of antitrust risks. This requires both a deep understanding of the client's business objectives and the courage to suggest alternative strategies that may carry less antitrust risk. There are many examples of this hierarchy. Joint ventures are usually safer than mergers, and long-term contracts are usually safer than joint ventures. Contracts that specify minimum quantities are safer than exclusive dealing arrangements. Incentive discounts based on relative increases in volumes purchased are safer than discounts based on total volumes, and volume discounts generally are safer than 'loyalty' discounts based on the percentage share of the buyer's purchases. In general, strategies that depend on the 'pull through' of customer demand through creation of better value are safer than strategies that depend on a 'push through' dealer. Terminations with a soft landing are safer than terminations that are abrupt. All of these things are true in the United States as well as in the European Union, because – regardless of what the cases hold or the antitrust authorities say – the risks of expensive litigation cannot be ignored.

When alternative strategies are subject to the rule of reason, the decision on whether various antitrust risks are tolerable is one for business managers. The lawyers' job is to identify and quantify the relative risks, as best they can, including the likelihood of litigation as well as the likelihood of ultimate victory. This is called creative counselling. In addition, even though it is not the business of antitrust, many prudent managers are very much aware of the possible adverse political or public-relations consequences of particularly aggressive competitive policies. For them, these political and social facts may have real economic consequences, and less restrictive options may be appealing.

Business managements' caution and willingness to consider alternatives may help to explain why longstanding anomalies in US antitrust law continue to exist. For example, antitrust commentators almost unanimously disfavour application of the *per se* rule

against vertical price-fixing, and the Robinson-Putman Act in its entirely. But, even those businesses most directly affected have never been willing to spend the political capital needed to get rid of these anomalies. The matter is simply not all that important for them because they have found practical ways to live with the anomalies, just as they have found practical ways to accommodate uncertainties.

Nervous counsellors can draw comfort from the fact that many managers prefer to operate in the broad colour fields of the Rothko world, rather than in the fuzzy boundaries. For them, subtle differences between outcomes in the United States and the European Union are less likely to be matters of great concern.

Notes

* The opinions expressed in this paper are informed by my experiences as a Federal Trade Commissioner, and as an in-house lawyer for General Motors, Corp, as well as my work at Hogan & Hartson. Specifically, I learned a lot about management of legal risk at General Motors and, at the Federal Trade Commission, I had to vote on a number of matters where eminent advocates applied Chicago economics to support opposing conclusions.

1 The publication of Columbia University Center for Law and Economic Studies, *Industrial Concentration: The New Learning introduced these ideas to the broader legal community* (Harvey J Goldschmid, et al. eds, Little Brown 1974).

2 See, eg William E Kovasic, 'The Modern Evolution of U.S. Competition Policy Enforcement Norms' (2003) 71 Antitrust LJ 377.

3 See Thomas Leary, 'The Bipartisan Legacy' (2005) 80 Tul L Rev 605, 606.

4 See, eg *Brown Shoe Co v United States*, 370 US 294 (1962), and Robert H Bork's discussion of the 'nine major ideas' that once underlay merger-law enforcement, in *The Antitrust Paradox 201* (Basic Books, Inc 1978).

5 See Bork, *supra* n 4 at 171. See also similar comment at 138.

6 See, eg *Rothery Storage & Van Co v Atlas Van Lines, Inc*, 792 F 2d 210 (DC Cir 1986) (preliminary screen to test for the existence of market power).

7 961 F 2d 667 (7th Cir 1992) (Easterbrook, J).

8 *Copperweld Corp v Independence Tube Corp*, 467 US 752 (1984).

9 *Chicago Professional Sports Ltd v Nat'l Basketball Ass'n*, 95 F 3d 593, 599-600 (7th Cir 1996).

10 *Supra* n 7, at 673-674.

11 For a discussion of similar complexities, see Thomas Leary, 'The Significance of Variety in Antitrust Analysis' (2001) 68 Antitrust L J 1007.

12 *Supra* n 6.

13 US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines §1.0 (rev 1997), reprinted in 4 Trade Reg Rep (CCH) ¶13, 104.

14 See, eg *State of NY v Anheuser Busch, Inc*, 811 F Supp. 848, 872 (EDNY 1993) ('the weighing required by the rule of reason is extremely awkward to apply').

15 In addition to the factors outlined above, it is important to remember that for most people in the European Union the hypothetical joint guidelines would be written in a foreign language, with unfamiliar or varied overtones.

16 IBA Antitrust Committee, *Comments on the DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* at §4.2.4.

17 Thomas Leary, 'Antitrust Planning in an Era of Uncertainty', CCH Business Strategies ¶2450, at 15,201 (1984).

18 For a review of this evolution, see Thomas Leary, 'The Essential Stability of Merger Policy in the United States' (2002) 70 Antitrust L J 105, 114-21.