# ST. JOHN'S SCHOOL OF LAW

LEGAL STUDIES RESEARCH PAPER SERIES

# ANTITRUST LAW AND ECONOMIC THEORY: FINDING A BALANCE

Paper Number 13-0006, April 2013

Edward D. Cavanagh

E-mail Comments to:
cavanage@stjohns.edu
St. John's University School of Law
8000 Utopia Parkway
Queens, NY 11439

ABSTRACT

ANTITRUST LAW AND ECONOMIC THEORY:
FINDING A BALANCE

Over the past forty years, the federal courts have relied more and more on economic theory to inform their antitrust analyses. Economic theory has indeed provided into antitrust issues and assisted the courts in reaching rational outcomes. At the same time, infusion of economic evidence into antitrust cases has made these cases more complex, lengthier, more expensive to litigate and less predictable.

This article argues that courts need to restore the balance between facts and economic theory in undertaking antitrust analysis. The problem is not that judges and juries cannot reach good outcomes in antitrust cases but rather that courts have become too reliant on economic theory in deciding antitrust issues. Just as courts of an earlier generation became too enamored of per se rules in antitrust cases, some courts today have become too enamored of economic theory in addressing and resolving antitrust issues. Some courts have lost sight of basic antitrust goals and have gotten bogged down in arcane economic tests -- relevant market and proof of common impact in class action cases are two examples -- which have become obstacles to, instead of tools for, resolution of antitrust disputes. Antitrust is a body of law enacted by Congress and construed by the courts; antitrust is not a compendium of the latest thinking in economic theory. The role of the courts is not to decree economic policy but rather to implement antitrust policies enacted by Congress. Antitrust has always been a fact-specific enterprise, and courts need to restore the proper balance between fact finding and economic theory by confining economic theory to those areas where it assists antitrust analysis and discarding theory where it gets in the way. In short, we need a return to simple, predictable and administrable -- but informed -- antitrust rules.

# ANTITRUST LAW AND ECONOMIC THEORY: FINDING A BALANCE

Edward D. Cavanagh
Professor of Law
St. John's University
School of Law

ANTITRUST LAW AND ECONOMIC THEORY:
FINDING A BALANCE

Edward D. Cavanagh*

"Antitrust law is not that complicated."[1] Richard M. Steuer.

## I. Introduction

The prohibitions of the antitrust laws are disarmingly simple. Section 1 of the Sherman Act declares unlawful any "contract, combination or conspiracy… in restraint of trade."[2] Section 2 bars "monopolization, attempted monopolization or conspiracy to monopolize."[3] Section 7 of the Clayton Act prohibits acquisitions "where in any line of commerce or any activity affecting commerce in any section of the country, the effect of such acquisition may be to substantially lessen competition, or to tend to create a monopoly."[4] Richard Steuer has suggested that these statutory prohibitions can be distilled down to two types of behavior: ganging up and bullying.[5]

Notwithstanding the simplicity of the statutory formulations, application of the antitrust laws to day-to-day business practices has proven to be no facile undertaking. Any attempt to re-create real-world price-output decisions in the courtroom is a daunting task,[6] requiring courts to undertake detailed examinations of market facts and to analyze the views of opposing economics experts as to whether the conduct in question ultimately promotes or impairs competition. Indeed, the Supreme Court has long held that alleged anticompetitive conduct must be analyzed in its factual context and condemned only if on balance anticompetitive effects outweigh procompetitive benefits.[7] On the other hand, it has also cautioned that courtrooms should not be

*Professor of Law, St. John's University School of Law.

[1] Richard M. Steuer, The Simplicity of Antitrust Law, 14 U. Pa. J. Bus. L. 543, 557 (2012).
[2] 15 U.S.C. §1 (2010).
[3] 15 U.S.C. §2 (2010).
[4] 15 U.S.C. §18 (2010).
[5] Steuer, *supra*, n.1 at 543.
[6] Illinois Brick Co. v. Illinois, 431 U.S. 720, 731-32 (1977) ("stressing the uncertainties and difficulties 'in analyzing price and output decisions in the real world rather than in the economist's hypothetical model.'") (Citation omitted).
[7] Chicago Bd of Trade v. United States, 246 U.S. 231, 238 (1918).

transformed into intermediate microeconomics classrooms.[8] Put another way, there is a limit on the amount and type of economic evidence that a trial court can competently entertain.

Pinpointing that limit has proven to be a challenge for antitrust courts. In the early years of the antitrust laws, the courts favored predictable, workable rules and sought to avoid detailed assessment of economic evidence, thereby giving birth to an era of per se analysis. Horizontal price fixing[9] and division of markets,[10] as well as tying arrangements,[11] were summarily condemned. Courts also condemned out of hand, at least initially, resale price maintenance[12] and vertically imposed territorial restraints.[13] Over the years, a strong consensus for per se treatment of horizontal arrangements affecting price has emerged. The same is not true for vertical restraints, and whatever consensus for per se treatment of vertical restraints that may have existed collapsed under the weight of cogent Chicago School criticism. Chicago School economists, relying on the neoclassical model and its two basic assumptions that (1) markets are self-correcting; and (2) firms and consumers generally behave rationally and act as profit-

---

[8] See Illinois Brick, 431 U.S. at 741-42, wherein the Supreme Court underscored the limitations of using economic evidence to re-create real world price/output decisions.

> Under an array of simplifying assumptions, economic theory provides a precise formula for calculating how the overcharge is distributed between the overcharged party (passer) and its customers (passees). If the market for the passer's product is perfectly competitive; if the overcharge is imposed equally on all of the passer's competitors; and if the passer maximizes its profits, then the ratio of the shares of the overcharge borne by passee and passer will equal the ratio of the elasticities of supply and demand in the market for the passer's product. Even if these assumptions are accepted, there remains a serious problem of measuring the relevant elasticities the percentage change in the quantities of the passer's product demanded and supplied in response to a one percent change in price. In view of the difficulties that have been encountered, even in informal adversary proceeding, with the statistical techniques used to estimate these concepts, [citation omitted] it is unrealistic to think that elasticity studies introduced by expert witnesses will resolve the pass-on issue.

[9] United States v. Socony Vacuum Oil Co., 310 U.S. 150 (1940).
[10] United States v. Topco Assocs., 405 U.S. 596 (1972).
[11] *See*, e.g., Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958).
[12] Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
[13] United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967).

maximizers,[14] urged that vertical restraints are rarely, if ever, anticompetitive and almost always serve to promote competition.[15] In the mid-1970's, courts, swayed by Chicago School scholars, began to embrace economic theory in examining antitrust issues;[16] and the neoclassical model became the predominant vehicle for antitrust analysis.[17]

Not surprisingly, now that economics and econometrics are front and center in antitrust analysis, the first call, once clients have "lawyered up," is to an expert economist. Particularly in merger cases, a team of expert economists with a phalanx of support staff appears on the scene immediately. Economics "has provided greater insight [to antitrust issues] but added to the terminological clutter."[18] But, terminological clutter is only one of the many problems resulting from the influx of economic data in assessing whether particular conduct violates the antitrust laws. Discovery is lengthier and even more expensive; in limine motions challenging expert evidence under *Daubert* have become routine; issues have grown more complicated; and outcomes are harder to predict. Courts in developing antitrust standards have long struggled to balance the need for detailed market analysis against the need for predictable, workable rules. These developments have not gone unnoticed by the Supreme Court. In recent decisions, the Court has acknowledged the challenges that economic analysis of antitrust issues presents to generalist judges and to juries.[19] Somewhat anomalously, the solution that the Court appears to

---

[14] J. Thomas Rosch, Comm'n Fed. Trade Comm., Remarks Before the Vienna Competition Conference, Behavioral Economics: Observations Regarding Issues that Lie Ahead (June 9, 2010) (transcript available at http://www.ftc.gov/speeches/rosch/100609viennaremarks.pdf.

[15] *See* Robert Bork, The Antitrust Paradox: A Policy at War with Itself at 288 (1978). ("Analysis shows that every vertical restraint should be completely lawful.")

[16] *See* Continental T.V., Inc. v. GTE Sylvania Inc. 433 U.S. 36, 57 (1977).

[17] *See* Amanda P. Reeves, Behavioral Antitrust: Unanswered Questions on the Horizon, Antitrust Source 1-4 (June 2010), http://americanbar.org/content/dam/aba/publishing/antitrust___source/June10___Reeves6___24f.avthcheckdam.pdf.

[18] Steuer, n. 1 at 543-44.

[19] *See* Bell Atl. Corp. v. Twombly, 550 U.S. 544, 558-59 (2007) (expressing doubt that "careful case management" and "lucid instructions to juries" can effectively eliminate infirm claims); Verizon Comm'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 415 (2004) (identifying unlawful exclusionary conduct would prove to be a "daunting task" for "generalist" antirust courts).

advocate is for trial courts to dismiss these cases at the outset rather than go through a costly and lengthy trial and run the risk of an erroneous outcome.[20] The irony here, of course is that on the one hand the Supreme Court encourages trial courts to admit economic evidence and then turns around and says that this type of evidence is too complicated for judges and juries to handle.

This article argues that courts need to restore the balance between facts and economic theory in undertaking antitrust analysis. The problem is not that judges and juries cannot reach good outcomes in antitrust cases but rather that courts have become too reliant on economic theory in deciding antitrust issues. Just as courts of an earlier generation became too enamored of per se rules in antitrust cases, some courts today have become too enamored of economic theory in addressing and resolving antitrust issues. Some courts have lost sight of basic antitrust goals and have gotten bogged down in arcane economic tests -- relevant market and proof of common impact in class action cases are two examples -- which have become obstacles to, instead of tools for, resolution of antitrust disputes. Antitrust is a body of law enacted by Congress and construed by the courts; antitrust is not a compendium of the latest thinking in economic theory. The role of the courts is not to decree economic policy but rather to implement antitrust policies enacted by Congress. Antitrust has always been a fact-specific enterprise, and courts need to restore the proper balance between fact finding and economic theory by confining economic theory to those areas where it assists antitrust analysis and discarding theory where it gets in the way. In short, we need a return to simple, predictable and administrable -- but informed -- antitrust rules.

[20] *See* Bell Atl. Corp. v. Twombly, 550 U.S. 544, 559 (2007) ("It is no answer to say that a claim just shy of a plausible entitlement to relief can, if groundless, be weeded out early in the discovery process through careful case management, given the common lament that the success of judicial supervision in checking discovery abuse has been on the modest side.") (internal citations omitted).

## II. The Foundational Principles of Antitrust in America

In his groundbreaking book, *The Antitrust Paradox: A Policy At War With Itself*,[21] the late Robert Bork argued that the Sherman Act was enacted to protect consumers, a view that has been accepted categorically by some antitrust courts, scholars and practitioners.[22] Bork's view, although perhaps "good economics," is "bad history."[23] Economic efficiency was not the driving force behind the Sherman Act. Rather, the antitrust movement was rooted in agrarian opposition to bigness and was driven by factors that were not exclusively economic in nature.[24] These values include:

> [F]irst, a fear that excessive concentration of economic power will breed antidemocratic political pressures and, second, a desire to enhance individual and business freedom by reducing the range with which private discretion by a few in the economic sphere controls the welfare of all. A third and overriding political concern is that if the free market sector of the economy is allowed to develop under antitrust rules that are blind to all economic concerns, the likely result will be an economy so dominated by a few corporate giants that it will be impossible for the state not to play a more intrusive role in economic affairs.[25]

Indeed, not until 1978 did the Supreme Court hold definitely that consumers could be "injured in [their] business or property" and thus would have standing to assert treble damage claims.[26]

This is not to suggest that economic efficiency is not (or should not be) a major goal of antitrust policy.[27] The point is simply that an antitrust regime driven exclusively by economic concerns is out of step with the fundamental concerns of the Sherman Act.[28]

---

[21] *See* Bork, *supra* n. 15 at 51 ("The only legitimate goal of American antitrust law is the maximization of consumer welfare").
[22] *Id.* at 17-21. *See*, e.g., Chesapeake & Ohio Ry. Co. v. United States, 704 F. 2d 373, 376 (7th Cir. 1983) (Posner, J.) ("The allocative efficiency or consumer-welfare concept of competition dominates current thinking, judicial and academic, in the antitrust field").
[23] David E. Bernstein, Lochner's Legacy's Legacy, 82 Tex. L. Rev. 1, 38 n. 213 (2003).
[24] Robert Pitofsky, The Political Content of Antitrust, 127 U. Pa. L. Rev. 1051, 1058-60 (1979).
[25] *Id*. at 1051.
[26] Reiter v. Sonotone Corp., 442 U.S. 330, 340-42 (1979).
[27] Pitofsky, *supra*, n. 24 at 1051.
[28] *Id.*

## III. The Evolution of Antitrust Jurisprudence

### A. Simple Rules (1890-1977)

#### 1. Section One of the Sherman Act

Section one of the Sherman Act prohibits "every contract, combination… or conspiracy in restraint of trade."[29] Initially, the courts had some difficulty defining "restraint of trade. In *Trans-Missouri*,[30] Justice Peckham, construing section one literally, ruled that section one prohibits any and all agreements that restrain trade.[31] Subsequently, Judge Taft, writing for the Sixth Circuit in *Addyston Pipe*,[32] ruled that ancillary restraints of trade, lawful at common law, are lawful under the Sherman Act, if reasonable but that naked restraints of trade -- restraints whose sole purpose is to restrain competition -- are unlawful on their face.[33] In *Standard Oil*,[34] the Supreme Court rejected Justice Peckham's literal approach and held that the term "every" in section one should not be construed literally and that section one prohibits on unreasonable restraints of trade.[35] Thus was born the Rule of Reason as the operative legal standard under section one of the Sherman Act. Thereafter, in *Chicago Board of Trade*,[36] the Court elaborated on the application of the Rule of Reason to a given set of facts:

> But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its

[29] 15 U.S.C. §1 (2010).
[30] United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).
[31] *Id*. at 318.
[32] United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898).
[33] *Id*. at 282-84.
[34] Standard Oil Co. v. United States, 221 U.S. 1 (1911).
[35] *Id*. at 59-60.
[36] Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

> condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.[37]

In short, under the Rule of Reason, a court must weigh procompetitive benefits against anticompetitive effects and determine, on balance, whether particular conduct restrains trade. This is a demanding task; and, not surprisingly, courts began to look for shortcuts in the application of the Rule of Reason. Early on, the courts determined that some horizontal arrangements – notably agreements among competitors to fix prices[38] or to divide territories[39] – were so pernicious and so likely to be devoid of procompetitive benefits that they could be condemned as unlawful without a detailed inquiry into market facts.

Per se rules offer several significant benefits to courts and litigants alike. First per se rules create bright-line demarcations, making it clear whether the conduct in question is lawful or unlawful.[40] Clarity is particularly important in horizontal price-fixing cases where a violation can give rise to criminal sanctions and potential treble damages liability.[41] Second, per se rules provide predictability to those making business decisions.[42] Unlike the Brandeis formulation of the Rule of Reason, which essentially provides an *ex post* assessment of conduct that has already occurred, the per se rule provides an *ex ante* guidepost as to the legal risk of undertaking certain conduct. Third, per se rules are readily administrable by the courts.[43] Per se rules, both limit

[37] *Id*. at 238.
[38] *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 166-68 (1940).
[39] *See* United States v. Topco Assocs., 405 U.S. 596, 609 n. 10 (1972).
[40] *See* Edward D. Cavanagh, The Rule of Reason Re-Examined, 67 Bus. Lawyer 435, 445 (2012).
[41] *Id*.
[42] *Id.*
[43] *Id*.

proof and remove from the courts the burden of weighing procompetitive benefits against anticompetitive effects.[44] That burden is considerable. As Justice Marshall observed in writing for the majority in *Topco*:[45]

> The fact is that courts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion in another sector is one important reason we have formulated *per se* rules.[46]

Given these practical difficulties, Marshall observed that absence a directive from Congress, courts are not "free to ramble through the wilds of economic theory in order to maintain a flexible approach."[47] Fourth, per se rules promote efficiency.[48] Precisely because per se rules limit proof at trial, they limit the cost of adducing evidence and the lengths of trials. Limitations on the amount of proof also typically means simplification of issues and less wear and tear on both the court and litigants.

Not surprisingly, developments in the law of vertical restraints mirrored those in the horizontal area, at least initially. Thus, resale price maintenance[49] and vertically imposed territorial restraints,[50] such as location clauses, were condemned as per se unlawful. In formulating rules governing vertical restraints, the courts again studiously avoided incorporating economic analysis. For example, the Supreme Court in *Dr. Miles* summarily condemned resale price maintenance, not because it inevitably lends to higher prices for consumers but rather because it violated the traditional common law rule against restraints on alienation.[51] Despite the clear ruling in *Dr. Miles* condemning vertical price fixing, resale price maintenance has never

---

[44] *Id*.
[45] United States v. Topco Assocs., 405 U.S. 596 (1972).
[46] *Id*. at 609-10.
[47] *Id*. at 610, n. 10.
[48] *See* Cavanagh, supra, n. 40 at 445.
[49] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
[50] United States v. Arnold Schwinn & Co., 388 U.S. 365 (1969).
[51] Dr. Miles, 220 U.S. at 404.

carried the same opprobrium as horizontal price-fixing. Criminal sanctions for r/p/m are almost unheard of.[52] Moreover, during the Great Depression, Congress permitted a revival of r/p/m by enacting so-called Fair Trade Laws which authorized states to pass legislation permitting manufacturers to impose their prices on retailers.[53]

On the other hand, the courts have waffled in their treatment of non-price vertical restraints. Initially, in *White Motor*, the Supreme Court rejected the government's arguments (and the decision below) that vertically imposed territorial restraints should be declared per se unlawful.[54] However, five years later in *Schwinn*, the Supreme Court changed its tune condemned out of hand non-price vertical restraints imposed on dealers when the manufacturer departed with "title, dominion and risk."[55] On the other hand, where the manufacturer retained title, dominion and risk by restructuring sales transactions as agency arrangements or consignment deals, the restraints would be upheld where reasonable.[56] The *Schwinn* rule was heavily criticized because it was directed to the form, not the substance of a transaction.[57] Many enterprises preferred sales to agency distribution models, but some firms attempted to take advantage of the *Schwinn* safe harbor. The post-*Schwinn* treatment of vertically imposed territorial restraints followed an erratic course in the lower courts.[58] As a halfway measure, some sellers abandoned location clauses and chose to impose less restrictive measures, such as areas of primary responsibility clauses, which required a dealer to exploit a given territory or "pass-over"

---

[52] *But see* United States v. Cuisinarts, Inc., Crim. No. H-80-49, Civ. No. H-80-559, 1981-1 Trade Cas. (CCH) π 63, 979 (D. Conn. Dec. 19, 1980) (resulting in a nolo contendere plea and a fine of $250, 000).
[53] *See*, e.g., Miller-Tydings Act, ch. 690, tit. 8, sec. 1, §1, 50 stat. 693, 693-94 (1937); McGuire Act, ch 745, sec. 2, §5 (a1(2)-(5), 66 Stat. 631, 632 (1955).
[54] White Motor Co. v. United States, 372 U.S. 253, 261 (1963) ("This is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.")
[55] Schwinn, 388 U.S. at 379.
[56] *Id*. at 381.
[57] Borke, *supra*, n. 15 at 285 ("Antitrust is capable of sustaining meaningless distinctions and stale paradoxes, but those of *Schwinn* were too many and to obvious to persist for long. The precendent suffered a timely and deserved demise shortly after its tenth anniversary.")
[58] *See* Response of Carolina, Inc. v. Leasco Response, Inc. 537 F. 2d 1307, 1313-20 (5th Cir. 1976).

clauses, which required invading dealers to compensate the dealers whose area of primary responsibility had been infringed for lost promotional and advertising expenses.[59] These were, at best, stop-gap measures and did not address the real problem that the *Schwinn* rule was directed at form, not substance.

2. Section Two of the Sherman Act

Historically, there have been two approaches to monopolization law: the conduct approach and the structural approach.[60] The former approach focuses on bad acts by dominant firms.[61] Under the structural approach, size alone may be sufficient to condemn a dominant firm; that is, bigness is badness.[62] In the landmark *Standard Oil* decision in 1911, the Supreme Court focused largely on the predatory acts of Standard Oil in achieving total dominance in the oil business.[63] In the mid-twentieth century, the structural approach came into vogue, perhaps best exemplified by Learned Hand's opinion in *Alcoa*.[64] The structural theory, however, has never gained traction in the Supreme Court; and post-*Alcoa* cases have stressed that proof of market dominance as well as bad acts are essential to establishing a monopolization claim. The common thread to both these approaches was that each was intuitive in nature. In *Standard Oil*, the Supreme Court condemned the bullying tactics – predatory pricing, secret rebates, consolidation under false pretenses – of a dominant firm without any meaningful effort to draw a line between lawful and unlawful behavior.[65] In *Alcoa*, Learned Hand stressed the virtues of

[59] Superior Bedding Co. v. Serta Assocs. Inc., 353 F. Supp. 1143 (N.D. Ill. 1972).
[60] Oliver Williamson, Dominant Firms and the Monopoly Problem: Market Failure Considerations, 85 Harv. L. Rev. 1512 (1972).
[61] *Id*.
[62] *Id.* at 1513.
[63] *Standard Oil*, 221 U.S. at 42- 43.
[64] United States v. Aluminum Co. of America, 148 F. 2d 416 (2d Cir. 1945).
[65] *Standard Oil*, 221 U.S. at 42-43; 72-77.

competition and the dangers that inevitably arise from the lack of competition.[66] Unlike the highly developed section one case law, section two remains a fertile area for judicial analysis.

3. Section 7 of the Clayton Act

Section 7 of the Clayton Act prohibits mergers "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such [merger] may be substantially lesser competition, or to tend to create a monopoly."[67] As originally enacted in 1914, section 7 contained a loophole in that it addressed only those mergers accomplished through stock acquisition and did not affect mergers effectuated through asset acquisition.[68] That loophole was closed by enactment of the Celler-Kefauver Amendment in 1950;[69] and with that change in law, the era of merger enforcement began.

Two things are noteworthy about the section 7 standards. First, the statute requires evidence of likely anticompetitive effect in "any line of commerce … in any section of the country;" at a minimum, the merger must be analyzed in the context of the product market and geographic market in which they occur.[70] Then, the fact-finder must determine whether a merger is likely to lessen competition or — worse — create monopoly in the market as defined. Second, unlike section one of the Sherman Act, which requires proof of an actual restraint of trade to establish a statutory violation, mergers violate section 7 of the Clayton Act only where the effect those mergers *may be* substantially lesser competition or *tend* to create a monopoly.[71] The Clayton Act has a prophylactic element — missing in the Sherman Act — that permits public

[66] *Alcoa*, 148 F. 2d at 427 ("Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.")
[67] 15 U.S.C. § 18 (2010).
[68] 38 Stat. 730.
[69] 15 U.S.C. §§ 18, 21 (2010).
[70] 15 U.S.C § 18 (2010).
[71] *Id*. (emphasis added).

enforcers or private litigants to nip anticompetitive acquisitions in the bud *before* those acquisitions have caused actual harm to consumers. Thus, in evaluating mergers, courts have to predict the likely competitive impact of any transaction rather than simply determine whether competition has, in fact, been lessened. Economic data, including market definition, market power, entry and exit patterns, likely efficiencies, profitability and innovation provide the courts with the tools to make those decisions.

An historical review of merger enforcement underscores the importance of economic data in evaluating acquisitions under the Clayton Act. In the early years, the courts, focusing more on socio-political concerns than economic concerns in assessing mergers, both undervalued and underutilized economic data. The *Brown Shoe* case is textbook example.[72] Brown Shoe, the third largest shoe retailer with 1230 stores, acquired Kinney Shoes, the eighth largest shoe retailer with 350 stores.[73] Together, the merged entity would become the second largest shoe retailer and control 2.3% of retail shoe outlets and 7.2% of all shoe stores.[74] After defining the relevant product and geographic markets and reviewing the merger trends in the shoe industry, the Court found that in 118 cities, the combined Brown-Kinney market share would exceed 5%.[75] Focusing solely on structural effect the Court concluded that merger creating a firm with at least 5% of the relevant market was likely to diminish competition.[76]

Even more interesting was the Court's largely socio-political rationale for striking down the merger. First, the Court identified a significant trend toward concentration in the shoe industry and stated:

---

[72] Brown Shoe Co. v. United States, 370 U.S. 294 (1962).
[73] *Id*. at 297.
[74] *Id*. at 345-46.
[75] *Id.* at 343.
[76] *Id* at 343-44.

> If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved.[77]

Second, the Court ruled that mergers involving chain stores must be closely scrutinized because (1) chain stores can be isolated from competition; (2) chain stores can set styles that make it impossible for independent stores to keep competitive inventories; and (3) even in a fragmented industry and even where the merger results in control of small share of a particular market, the fact that the merged entity is a chain can adversely affect competition.[78] Citing evidence from independent retailers, the Court found that to be the case for the Brown-Kinney merger.[79]

Third, and most baffling, the Court found that as a result of the merger, Kinney could purchase shoes manufactured by Brown more cheaply than could rivals and that the savings realized from Brown purchases would give Kinney a competitive leg-up.[80] Although the Court recognized the potential benefits to consumers in the form of lower prices that would flow from the merger of two large integrated chain operations, such as Brown and Kinney, and that merger should not be condemned solely because small independent stores may be adversely affected, the Court, nevertheless, reasoned that the potential cost savings to Kinney were a reason to condemn the merger:[81]

> But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries

[77] *Id*.
[78] *Id* at 344.
[79] *Id*.
[80] *Id* at 343-44.
[81] *Id* at 344.

> and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.[82]

In other words, the merger was condemned because of the efficiencies that it was likely to produce. For that reason, *Brown Shoe*, has been pilloried by the critics.[83] Indeed, the Court's statement that antitrust law was meant to protect competition not competitors but that the merger still must be condemned because it adversely affects competitors embodies what Robert Bork has termed the antitrust paradox.[84] Still, *Brown Shoe* has never been overruled; and it set the tone for the Court's hostile attitude toward mergers throughout the 1960's.

Thereafter, in the *Philadelphia National Bank* case the Court struck down the merger of the second and third largest commercial banks in the Philadelphia metropolitan area.[85] The merged entity would be the largest commercial bank in Philadelphia with 30% of the market.[86] The top two banks would have 59% of the market, and the top four would have 78%.[87] The Court ruled that a merger creating (1) an undue percentage share of the market (presumably a share greater than 30%) and (2) a significant increase in concentration (here the concentration ratio of the two largest firms increased from 44% to 59%) is presumptively unlawful.[88] The burden then shifts to the merged entity to justify the merger.[89] Here, the Court rejected all arguments favoring the merger.[90] In particular, the Court rejected PNB's countervailing economic power argument — that an entity of its size was needed to compete with the large New

---

[82] *Id*.
[83] *See* Bork, *supra*, n. 15, at 210-15.
[84] *Id* at 216 ("No matter how many times you read it, that passage states: although mergers are not rendered unlawful by the mere fact that small independent stores may be adversely affected, we must recognize that mergers are unlawful when small independent stores may be adversely affected.").
[85] United States v. Philadelphia National Bank, 374 U.S. 321 (1963).
[86] *Id* at 330.
[87] *Id* at 331.
[88] *Id* at 363.
[89] *Id* at *Id*.
[90] *Id* at 370-72.

York City — based banks.[91] After pointing out that the largest New York City bank had more assets that all of the Philadelphia banks combined, the Court ruled that anticompetitive conduct in one market cannot be justified by procompetitive benefits in another market.[92] Similarly, the Court eschewed PNB's claim that the merger would spur economic development, concluding that a merger cannot be saved by the fact that when you add all the debits and credits, it may be beneficial.[93] Congress was aware of the possible economies to be attained by mergers but was determined "to preserve our traditionally competitive economy."[94]

In *PNB*, the Court left the door open a crack for horizontal mergers but later seemed to slam the door shut in *Von's Grocery*.[95] That case involved the merger of two Los Angeles area grocery chains, one having 4.7% of the market and the other 2.8%. [96] The Court struck down this merger, which created an entity with 7.5% of sales in the relevant market, after finding that (1) there was a market trend in concentration in the grocery store business, with individually owned stores declining by nearly 50% from 5365 to 3580 between 1950 and 1961; (2) in the same period, food chains had increased from 96 to 150; (3) nine of the top twenty chains had acquired 126 stores in that period.[97]

The Court in *Von's Grocery* made no effort to appraise the anticompetitive effects of the merger in terms of the contemporary economy of the Los Angeles food industry and seemed blind to the fact that the world had changed. Consumers preferred the convenience, choice and cost-savings of supermarkets; Mom and Pop grocery stores were fast becoming extinct.

---

[91] *Id* at 370.
[92] *Id.* at 370-71.
[93] *Id.* at 71 ("We are clear, however, that a merger the effect of which may be substantially to lessen competition is not saved because, on some reckoning of social or economic debits and credits, it may be deemed beneficial.") (Internal quotation omitted).
[94] *Id.* at 371.
[95] United States v. Von's Grocery Co., 384 U.S. 270 (1966).
[96] *Id.* at 272.
[97] *Id.* at 277-81.

Frustrated with the lack of economic analysis in *Von's Grocery* and its predecessors dissenting Justice Potter Stewart opined that "[t]he sole consistency that I find [in Supreme Court merger pronouncements] is that in litigation under § 7, the Government always wins."[98] Not surprisingly, *Von's Grocery* effectively sounded the death knell for horizontal mergers for well over a decade. In the wake of that decision — where a merger between two rivals with less than 5% of the market is struck down — horizontal mergers were as *de facto per se* unlawful.

B. Rise of the Chicago School (1977-1992)

The 1970's marked the ascendancy of the Chicago School of thought as the predominant mode of antitrust analysis and policy making. The Chicago School holds that "allocative efficiency as defined by the market should be the only goal of the antitrust laws."[99] The Chicago School analysis is rooted in two fundamental assumptions of neoclassical economics: (1) markets are self-correcting; and (2) firms and consumers are rational actors and generally act as profit-maximizers.[100] The neoclassic model, in turn, serves two interrelated functions. First it provides the economic assumption—the organizing principles—for modern antitrust analysis.[101] Second, the neoclassical model may be proffered in place of facts as proof of competitive effects of certain conduct, rather than simply as confirmation of existing factual evidence.[102] The Chicago School has had a profound effect on antitrust analysis most significantly, it has emboldened courts to "ramble through the wilds of economic theory" to reach good outcomes.[103]

[98] *Id* at 301 (Stewart, J. dissenting).
[99] Herbert Hovenkamp, Antitrust Policy After Chicago, 84 Mich. L. Rev. 213, 215 (1985).
[100] J. Thomas Rosch, Comm's Fed. Trade Comm'n, Remarks Before the Vienna Competition Conference, Behavioral Economics: Observations Regarding Issues That Lie Ahead (June 9, 2010) (transcript available at http://www.ftc.gov/speeches/rosch/100609viennaremarks.pdf.
[101] *Id.*
[102] *Id.*
[103] *Cf. Topco*, 405 U.S. at 610 n. 10.

1. Section One of the Sherman Act

Chicago School adherents agree that horizontal agreements affecting price are pernicious and should be condemned out of hand.[104] The infusion of economic thought has had a profound effect on the development of antitrust law across the board, but has been most influential in the area of vertical restraints. As discussed above, the early decisions involving vertical restraints mirrored those involving horizontal restraints.[105] Price-fixing among competitors and horizontal division of markets were condemned as per se unlawful because the courts understood that (1) these restraints misallocated resources, thereby creating waste, leading to higher prices and lower output; and (2) any benefits arising from such restraints were speculative and at best marginal and hence not worth any effort to quantify.[106] The courts then subjected vertically imposed price restraints and vertically imposed territorial restraints to similar per se condemnation but without any compelling rationale.[107] Indeed, the early decisions on vertical restraints failed to appreciate the fundamental differences in horizontal and vertical restraints. Calvin Klein and Ralph Lauren are competitors in the clothing industry. It is only natural that Ralph Lauren would seek to outsell Calvin Klein and reap substantially higher profits. If Calvin Klein and Ralph Lauren were cooperating instead of trying to outsell each other, their conduct would be suspicious.

This situation is fundamentally different, however, in the vertical arena. For example, Ralph Lauren sells to Saks, and Saks sells to consumers. Ralph Lauren and Saks are not rivals. Ralph Lauren needs Saks to get its goods to consumers. We therefore would not be surprised to see some cooperation between manufacturer and retailer. Such cooperation would not

---

[104] *See* Bork, supra, n. 15 at 263.
[105] *See*, *supra*, n. 49-50 and accompanying text.
[106] *See* FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 434 n. 16 (1990) ("[P]rice fixing cartels are condemned per se because the conduct is tempting to businessmen but very dangerous to society. The conceivable social benefits are few in principles, small in magnitude, speculative in occurrence and always premised on the existence of price-fixing power which is likely to be exercised adversely to the public").
[107] *See*, supra, n. 49-59 and accompanying text.

necessarily stymie competition in the way that horizontal agreements would. Cooperation among competitors would encourage output limitations in order to support higher prices. The incentives in the vertical area differ markedly. Suppose, for example, Ralph Lauren imposes a location clause on Saks and allows Saks to sell Ralph Lauren goods only from its New York stores. Here, Ralph Lauren would have no incentive to limit the volume of sales to Saks. To the contrary, Ralph Lauren would want to sell as much as possible to Saks. Limiting sales to Saks would not enable Ralph Lauren to elevate price levels. Simply put, vertically imposed territorial restraints do not invariably lead to higher prices and lower output.

More importantly, as the Supreme Court recognized in *GTE/Sylvania*, there are important economic reasons for a manufacturer imposing territorial restraints on its sellers.[108] Relying heavily the economics literature, the Court observed that territorial restraints can promote interbrand competition, *inter alia*, minimizing free riding, creating efficiencies in distribution and encouraging retailers to promote the manufacturer's products.[109] Accordingly, vertically imposed territorial restraints are not invariably anticompetitive and must be judged on a case by case basis.[110] Three decades later, in *Leegin*, the Supreme Court extended the rationale of *GTE/Sylvania* to cover vertically imposed price restraints, abandoning the per se rule in retail price maintenance cases.[111]

2. Section 2 of the Sherman Act

In the area of monopolization, Chicagoans are generally non-interventionists. Their arguments against monopolization enforcement have been ably summarized by Professor Jonathan Baker.

[108] Continental T.V. Inc. v. GTE Sylavania, Inc. 433 U.S. 36, 54-56 (1977).
[109] *Id*.
[110] *Id* at 58-59.
[111] Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877, 916-17 (2007).

(1) Markets are self-correcting. Monopolization is not a serious problem because markets are generally self-correcting. That is, the exercise of monopoly power will predictably erode over time through entry or fringe expansion or, in high-tech markets, through leapfrog innovation. Hence false positives are more common and more costly than false negatives.

(2) Monopoly fosters economic growth. Monopoly is good, and monopolization enforcement counterproductive because the anticipated opportunity to charge a monopoly price induces the innovation and investment that lead to economic growth. Monopolization enforcement chills precompetitive innovation and investment by current and would-be dominant firms throughout the economy, even in industries not directly involved in monopolization cases.

(3) There is only a "single monopoly profit." A monopolist has already obtained its monopoly products that is often treated as suspect, e.g., by competing in related markets (sometimes selecting an exclusive distributor or exclusive supplier.

(4) Excluded fringe rivals may not matter competitively. The exclusion of horizontal rivals to a dominant firm may not matter to market performance. Excluded fringe rivals are often small because they are inefficient, high-cost producers.

(5) Courts cannot reliably identify monopolization, or effectively remedy or regulate it. Antitrust enforcement is not well-suited for improving market outcomes because of the limited exclusionary conduct by a monopolist because of the difficulty disentangling the benefits to competition from the harms when the efficiencies arise in the same market where market power is alleged. Nor can judges easily devise remedies for monopolization, even when a problem is uncovered, particularly when slow-moving courts are asked to deal with fast-moving high-tech markets. Not surprisingly, the history of monopolization enforcement is littered with misguided lawsuits and ineffective or counterproductive remedial decrees.

(6) The prohibition on monopolization is subject to misuse. Much monopolization litigation, government cases included, is instigated by unsuccessful and inefficient rivals. Those firms, having lost out in the marketplace, seek to reverse that misfortune in the courts, either as plaintiffs or as instigators of enforcement agency lawsuits, through trumped up claims of exclusion. Even successful rivals may bring unwarranted exclusion claims, moreover, in order to discourage the dominant firm from engaging in hard competition.[112]

One area of disagreement among Chicagoans with respect to monopolization is the treatment of predatory pricing. Judge Easterbrook would opt for a rule of per se legality because lower prices almost always benefit consumers.[113] Judge Posner, on the other hand, would

[112] Jonathan B. Baker, Preserving A Political Bargain: The Political Economy of The Non-Interventionist Challenge To Monopolization Enforcement, 76 Antitrust L.J. 605, 607 (2010).
[113] Frank H. Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 264 (1981).

challenge below-cost pricing where that conduct would eliminate an equally efficient competitor from the field.[114]

However, perhaps the most important development in antitrust jurisprudence in the Chicago School era -- the modern approach to predatory pricing -- was *not* decided in Chicago, having originated with Harvard's Areeda and Turner.

Courts have been traditionally suspicious of dominant firms but, at the same time, have recognized that the law cannot condemn those who have gotten big by playing within the rules. Richard Steuer has aptly described predatory pricing as "bullying;"[115] and courts have had difficulty distinguishing when price cuts by dominant firms are lawful competitive tools and when they constitute an abuse of dominance. The early predatory pricing cases focused largely on subjective factors; e.g. did the defendant *intend* to drive a rival from the field?[116] That subjective standard has now proven to be neither wise nor administrable.

First, anticompetitive intent involves state of mind and is difficult to prove. Second, the test is overinclusive. In a competitive environment, it is only natural that a seller would wish to drive rival from the field.[117] That is what true competition is all about — winning. Statements to the effect that a seller wishes to "crush" rivals or drive rivals out of business reflect the desire to compete at least as much as predatory intent and therefore are not particularly probative of predatory behavior.[118] Third, price reductions, even price reduction by dominant firms, are generally beneficial to consumers; and an overly broad prohibition of price cuts by dominant

[114] Richard A. Posner, The Chicago School of Antitrust Analysis, 127 U. Pa. L. Rev. 925 (1979); *see* Richard A. Posner, Antitrust Law: An Economic Perspective 194-95 (2d ed. 2001).
[115] Steuer, *supra*, n. 1 at 543.
[116] *See*, e.g., Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 703 (1967).
[117] *See* A.A. Poultry Farms v. Rose Acre Farms, 881 F. 2d 1396, 1402 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990) ("intent is not a basis of liability (or a ground for inferring the existence of such a basis) in a predatory pricing case under the Sherman Act.")
[118] Olympic Equipment Leasing Co. v. Western Union Tel. Co., 797 F. 2d 370, 379 (7th Cir. 1986) ("if conduct is not objectively anticompetitive, the fact that it was motivated by hostility to competitors… is irrelevant.").

firms is likely to chill procompetitive behavior.[119] Fourth, a subjective standard is simply too difficult for courts to administer fairly, consistently and efficiently.[120]

In the 1970's, Professor Areeda and Turner argued that the focus on subjective intent in alleged predation cases was misguided and suggested an objective, cost-based standard. In their view, predatory pricing rarely occurred and was even more rarely successful.[121] Areeda and Turner proposed bright-line, cost-based rules to identify pricing behavior that was truly predatory.[122] Prices above a firm's marginal cost were viewed as per se lawful and prices below marginal costs were per se illegal under the Areeda/Turner formulation.[123] Recognizing the practical difficulties involved in deriving marginal cost, they proposed that average variable cost be used as a surrogate for marginal cost.[124]

This cost-based approach has been widely adopted in the lower courts.[125] In *Brooke Group*, the Supreme Court adopted a version of the Areeda/Turner test, ruling that the offense of predatory pricing requires (1) proof of pricing below a reasonable measure of cost; and (2) proof of a dangerous probability that the seller will be able to recoup its short term losses by exacting long term monopoly rents.[126] In so holding, the Court did not hold that marginal cost or average variable cost would be the exclusive measure of cost in predatory cases, nor did it rule out some other measure of cost as appropriate in a given case.[127]

---

[119] *See* A.A. Poultry Farms, 881 F. 2d at 1402.
[120] *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 225-27 (1993).
[121] Phillip Areeda and Donald Turner, Predatory Pricing and Related Practice Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 708-09 (1975).
[122] *Id*. at 116.
[123] *Id*.
[124] *Id* at 716-18.
[125] *See*, e.g. Hanson v. Shell Oil Co., 541 F. 2d 1352, 1358 (9th Cir. 1976).
[126] Brooke Group, 509 U.S. at 225-26.
[127] *Id*. at 222-24.

3. Section 7 of the Clayton Act

As discussed above,[128] the courts in the wake of *Brown Shoe* were decidedly hostile to mergers. Two events brought about a fundamental reshaping of the merger landscape cultivated by the Supreme Court in the 1960's: (1) the enactment in 1976 of the Hart-Scott-Rodino Antitrust Improvements Act ("HSR")[129] and (2) the promulgation of the 1982 Merger Guidelines by the Antitrust Division and the FTC.[130]

a. Hart-Scott-Rodino

The HSR Act required parties to a merger of any real size, prior to consummating their deal, to notify (confidentially) the Antitrust Division and the Federal Trade Commission of the proposed merger.[131] Once the agencies are notified, the merger may not be consummated for at least 30 days, unless the government grants an early termination of the waiting period.[132] Prior to HSR, the government generally would be unaware of a given merger until after it had been consummated. A principal aim of HSR was to give enforcers the opportunity to review (and possibly challenge) a merger *before* it had been effectuated. It is far easier to challenge a merger before it occurs; once a merger takes holds, trying to undo that merger is a bit like untying a pretzel.

During the 30-day HSR waiting period, the reviewing agency may decide that no enforcement action is appropriate or may choose to challenge the merger.[133] The vast majority of HSR investigations are terminated without enforcement action. In some instances, the

[128] *See*, *supra*, n. 94-97 and accompanying text.
[129] 15 U.S.C. § 18a et seq.
[130] U.S. Dep't of Justice and Fed. Trade Comm'n Merger Guidelines (1982) available at www.justice.gov/atr/hmerger/11248.htm.
[131] 15 U.S.C. § 18a.
[132] *Id*.
[133] *Id*.

reviewing agency may make a "second request" for additional information.[134] The response to the second request may lead to challenge to the transaction by the agency. Usually, the agency will identify what it deems to be the anticompetitive aspects and how the merging parties can address the problem by, for example, spinning off certain holdings. If the merging parties agree, they will enter into a consent decree; and the transaction will go forward as modified by the consent decree.[135] However, mergers are rarely challenged in the judicial arena.

The end-result of the HSR process is that merger practice is now handled administratively by the agencies and not judicially by the courts. Indeed, there has not been a substantive merger case decided by the Supreme Court since the *General Dynamics*[136] case in 1974, which predated HSR by two years.

b. The 1982 Merger Guidelines

The 1982 Merger Guidelines, jointly issued by the Antitrust Division and FTC, also had a profound effect on modern merger analysis. The Guidelines were intended to (1) reduce any uncertainty surrounding evaluation of mergers by providing an analytical roadmap to merger enforcement; and (2) bring the merger enforcement policies of the 1960's in line with subsequent developments in antitrust law and economics.[137] The unifying theme of the 1982 Guidelines is that only those mergers create or enhance market power should be challenged under section 7 of the Clayton Act. The 1982 Guidelines evaluate mergers based on the protection and enhancement of economic efficiency, and not based on socio-political concerns. To that end, the 1982 Guidelines set forth a rigorous, step-by-step economic analysis of mergers.

1. Define relevant product and geographic markets:

---

[134] *Id.*
[135] American Bar Association Antitrust Section, Antitrust Law Developments (7th ed. 2012) at 401-12 (hereafter "ALD VII").
[136] United States v. General Dynamics Corp., 415 U.S. 486 (1974).
[137] William E. Baxter, Responding to the Reaction: The Draftsman's View, 71 Cal. L. Rev. 618 (1983).

2. Identify all participants in that market.
3. Determine each participant's share of the relevant product market.
4. Determine market concentration in the post-merger market.
5. Determine the change in market concentration as a result of the merger.
6. View the post-merger market concentration and change in concentration against standards set forth in the Guidelines.
7. Analyze the competitive effects of the merger.
8. Analyze other factors, such as entry, that might mitigate or enhance anticompetitive effects.
9. Determine whether the failing company defense applies.[138]

The Merger Guidelines have been updated from time to time, most recently in 2010.[139] The Merger Guidelines have been widely hailed for the intellectual rigor they bring to the merger review process, an element notably lacking in the 1960's merger case law. On the other hand, the Merger Guidelines have been subject to criticism.[140] As more fully discussed below,[141] one major criticism is that the enforcement agencies have not always applied the Guidelines as written; *i.e.*, have chosen not to prosecute cases that the Guidelines suggest should be pursued.[142] The end result is that very few mergers have been challenged administratively and even fewer in the courts.

[138] *See* U.S. Dep't of Justice and Fed. Trade Comm'n Merger Guidelines (1982) available at www.justice.gov/atr/hmerger/11248.htm.
[139] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 64 & ex. 19 (2010), available at http://www.justice.gov/atr/public/guidelines/hmg-2010.html; *see infra*, nn. 175-80 and accompanying text.
[140] Carl Shapiro, The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years, 77 Antitrust L. J. 49 (2010).
[141] *See*, infra, nn. 159-174 and accompanying text.
[142] *See* Shapiro, *supra*, n. 140 at 57-58.

## IV. Where Economics Has Failed Antitrust Analysis

### A. Mergers

Unquestionably, the 1982 Merger Guidelines were a step forward in merger analysis by requiring a rigorous assessment of the likely economic effects of an acquisition in place of blanket presumptions utilized by the courts in the 1960's based on market structure and trends toward concentration that effectively rendered most horizontal mergers per se unlawful. The 1982 Guidelines, however, brought with them their own set of problems. First, the Guidelines' rigid requirement that relevant product and geographic markets at the outset of the analysis permitted mergers that should have been challenged to slip through the net. Second, the 1982 Guidelines were rarely enforced as written and numerous mergers went unchallenged when the Guidelines themselves called for challenge. Third, thoughtful attempts to revise the Guidelines in 2010 have further -- and unnecessarily -- complicated merger analysis.

1. Market Definition

The Supreme Court in *Brown Shoe* ruled that market definition is a "necessary predicate" to any determination of the legality of a merger.[143] The 1982 Merger Guidelines embraced this approach and required, as an initial step in merger analysis, that relevant product and geographic markets be identified. Inevitably, the market definition exercise overshadowed the rest of the merger analysis process. Once relevant markets were defined, the outcomes were pretty much dictated. Merger assessments would begin and often end at the market definition stage.

The analytical error here is the notion that relevant markets actually exist. In fact, they do not. The concept of relevant market is an artificial construct. As the late Professor Lawrence Sullivan noted:

[143] Brown Shoe Co. v United States, 370 U.S. 294, 324 (1962).

> [E]conomic relationships are seldom so simple that a relevant market can be defined with exactitude and confidence. There is not for any product, a single real "market" waiting to be discovered.[144]

Similarly, Donald Baker has underscored the arbitrary nature of market definition, calling relevant market "a magic grouping of transactions around which a circle is drawn" and noting that "[u]nder traditional approaches the circle is impermeable – everything inside is fully counted and everything outside is ignored."[145]

In truth the market definition exercise is as much art as it is science, but the 1982 Guidelines approached the issue with the view that for a given set of transactions, there is but one product market and one geographic market.[146] The outcomes that emerge from this reasoning can be counter-intuitive. The XM-Sirius merger in 2008 is a prime example of this phenomenon. XM and Sirius, the only two providers of satellite radio services, agreed to merge. On its face, this appears to be a merger to monopoly, a clear violation of section 7 of the Clayton Act. The Antitrust Division, however, saw the matter differently. Accepting the broader market definitions proferred by the merging parties, it rejected a satellite radio market, in favor of the "mass-market retail channel" which would include AM/FM radio, HD radio, MP3 players and audio offerings delivered through wireless telephones.[147] That rather Procrustean market definition ignores the common sense reality that where there were once two satellite radio providers, there is now one -- a merger to monopoly.[148]

---

[144] Lawrence Sullivan, Antitrust Law § 12 at 41 (1977).
[145] Donald I. Baker, The 1982 Guidelines and Preexisting Law, 71 Cal. L. Rev. 311, 326 (1983).
[146] *See* Panel Discussion: The New Merger Guidelines, 51 Antitrust L.J. 317, 321 (1982) (remarks of William F. Baxter, Assistant Attorney General, stating that the concept of the submarket "has been terribly abused" and "the sooner we see the end to that kind of chatter the better").
[147] *See* Statement of the Department of Justice Antitrust Division on its Decision to Close its Investigation of XM Satellite Radio Holdings Inc. merger with Sirius Satellite Radio Inc. (March 24, 2008) (hereafter DOJ Closing Statement on XM-Sirius Merger), available at www.usdoj.gov.
[148] 15 U.S.C. § 18.

Market definition is not an end in itself under the antitrust laws but rather a tool for ascertaining whether market power exists.[149] Market definition is simply an analytical construct used to compensate for the inability to measure market power directly.[150] Anticompetitive effect should be the principal focus of merger analysis.[151] The Supreme Court has long recognized that "the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effect on competition" and that "proof of actual detrimental effects, such as a reduction of output can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'"[152] Accordingly, "the finding of actual, sustained adverse effects on competition… is legally sufficient to support a finding that the absence of elaborate market analysis."[153] The Court has never insisted on market analysis in per se cases under the Sherman Act. In *NCAA*,[154] the Court, although eschewing per se analysis, categorically rejected the defense that the NCAA lacked market power, ruling that "[a]s a matter of law, the absence of proof of market power does not justify a naked restriction on price or output."[155] The *NCAA* Court further observed that where price and supply are not responsive to consumer preference, "[w]e have never required proof of market power."[156]

Similarly, in monopolization cases arising under section 2 of the Sherman Act, market definition is unnecessary where plaintiff can adduce actual evidence of anticompetitive effect. Thus in *Image Technical Services*,[157] the Supreme Court found that evidence proffered by

[149] Sullivan, *supra*, n. 144 § 12 at 41.
[150] Baker, *supra*, n. 145 at 323; *see* Sullivan, *supra*, n. 144.
[151] *See* Sullivan, *supra*, n. 144 § 12 at 41.
[152] FTC v. Indiana Fed. of Dentists, 476 U.S. 447, 460 (1986).
[153] *Id*. at 461.
[154] NCAA v. Bd. of Regents of Univ. of Okla., 468 U.S. 85 (1984).
[155] *Id*. at 109.
[156] *Id*. at 110.
[157] Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451 (1992).

plaintiffs that Kodak forced consumers to pay higher prices for inferior Kodak maintenance services was evidence of market power sufficient to defeat a motion for summary judgment.[158]

### 2. Failure to Enforce the Guidelines as Written

A second problem with the Guidelines was the fact that the regulatory agencies did not enforce the Guidelines as written.[159] Again, the XM-Sirius merger illustrates the situation.[160] The Antitrust Division decided not to challenge that merger in part because it concluded that any competitive concerns would be outweighed by the efficiencies generated by the merger and the likelihood that new technologies would be developed to provide improved alternatives to satellite radio.[161] In approving the merger, the Antitrust Divisions conceded that it was unable to quantify or even estimate the magnitude of any efficiencies, even though the Guidelines themselves required that efficiencies offered to justify a transaction must be clearly identified and merger-specific.[162] Nor did the Antitrust Division identify the technology platform that would provide new or improved alternatives to satellite radio. Yet, the merger cleared regulatory scrutiny.

Perhaps even more glaring, was the consistent refusal of the agencies to follow their own Guidelines with respect to concentration levels. The Guidelines provided that a post-merger HHI of 1000 would fall within a safe harbor.[163] A post-merger HHI of 1000-1800 would raise competitive concerns where there are large concentration increases but unlikely to have adverse

---

[158] *Id*. at 465.
[159] *See* Shapiro, *supra*, n. 140 at 57-58.
[160] *See, supra*, n. 147-48and accompanying text.
[161] *Id*.
[162] *Id*.
[163] U.S. Dept. of Justice Merger Guidelines § 111, A (1982), available at http://www.justice.gov/atr/hmerger/11248.pdf.

competitive consequences where changes in concentration are small.[164] In markets with post-merger HHIs in excess of 1800, the merger would ordinarily be subject to challenge if the change in concentration as a result of the merger was 100 or more.[165]

In practice, the HHI thresholds were much higher. The *de facto* safe harbor was post-merger HHI of 2400 and an increase in concentration of at least 200, with most challenges directed at HHI's that were much higher.[166] The fact is that over time, the enforcement agencies relied less and less on structural factors and more on direct evidence of likely price increases were a merger to be consummated.[167] In 1992, the Merger Guidelines were revised to incorporate the unilateral effects doctrine as a cognizable legal basis for challenging a merger.[168] Under the unilateral effects doctrine, a merger may be set aside where the merged entity can unilaterally raise the price of its product, without the need to provide detailed analysis of the competitive environment.[169]

At first blush, the unilateral effects doctrine appears to be a step forward in merger enforcement. It deftly sidesteps the thorny question of market definition and attempts to focus merger analysis directly on price and output issues. It also provides an alternative to coordinated effects as a basis for challenging a merger. At the same time unilateral effects brings with it its own baggage. The economic debate shifts away from market definition to the equally complex

---

[164] *Id*. at III A.1.
[165] *Id*. at III A.2.
[166] *See* Deborah A. Garza, Market Definition, the New Horizontal Merger Guidelines and the Long March Away from Structural Presumptions, Antitrust Source 2, October 2010, citing FTC Horizontal Merger Investigation Data, Fiscal Years 1996-2007, tbls. 3.1-3.6 (2008), available at http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf.
[167] *Id*.
[168] *Id.*
[169] *Id.*

arena of diversion ratios, which, in turn, invites introduction and debate of complex economic theory.[170]

*Whole Foods*[171] is a case in point. The FTC challenged the Whole Foods/Wild Oats merger, arguing that under a critical diversion theory, the newly merged entity could profitably raise prices because Whole Foods own documents indicated that Wild Oats customers would prefer to shop at Whole Foods after the merger, as opposed to conventional supermarkets.[172] To counter this argument, the merging parties urged that under the theory of critical loss analysis, marginal customers would turn to conventional supermarkets and thereby thwart any effort by the newly merged entity to raise prices.[173] The key difference in these approaches was that critical loss theory depended only on loss of marginal sales, while the FTC critical diversion analysis turned on the average loss of customers because a "core of committed customers would continue to shop at [Whole Foods]" despite any post-merger price increase.[174]

The unilateral effects theory may well be a step forward in merger control, but even under this approach, the courts are immersed in complex economic analysis. It simply substitutes one form of economic complexity for another.

3. 2010 Guidelines

In 2010, the Justice Department and FTC promulgated a major revision of the Merger Guidelines.[175] The overarching goal of the 2010 revision was to bring the Guidelines in line with

---

170 *See*, e.g., Dennis W. Carlton, Comment on Department of Justice and Federal Trade Commission's Proposed Horizontal Merger Guidelines § 11.D (June 4, 2010), available at http://www.ftc.gov/os/comments/hmgrevisedguides/548050-00034.pdf (noting that the distinction between unilateral effects and coordinated effects may be confusing to businesses and to the courts).
171 FTC v. Whole Foods Market, Inc., 548 F.3d 1028 (D.C. Cir 2008).
172 *Id*. at 1038.
173 *Id.*
174 *Id.*
175 U.S. Dep't of Justice & Federal Trade Commission Horizontal Merger Guidelines, available at http://www.ftc.go/os/2010/08/100819hmg.pdf.

actual practice of the agencies.[176] To that end the thresholds for safe harbors and presumptive challenges were revised significantly.[177] In addition, the new Guidelines abandon the stepwise approach employed in earlier versions that began with market definition.[178] In part, this was a recognition that market definition, while not unimportant, had been given too big a role in merger analysis and had led to counterintuitive results.[179] Accordingly, anticompetitive effect is the principal focus of merger analysis.[180] By bringing the Guidelines into sync with actual agency practice, the 2010 revisions are an important step forward.

The new approach embodied in the 2010 Guidelines, however, creates problems of its own. In an effort to tap into the most recent thinking on likely anti-competitive effect of mergers, the Guidelines incorporate terminology and sophisticated economic analysis understood only by expert economists and foreign to corporate decisionmakers, lawyers and judges. The outcome turns on which of the dueling experts the finder of fact believers. The experts, in turn, analyze facts, invoke presumptions, spin out theory and develop econometric models that they urge can predict market behavior. All of this comes at a huge cost to the parties and introduces both complexities and a heavy dose of terminological clutter into the merger review process. As two respected antitrust commentators recently observed:[181]

> Throughout the customary antitrust investigation, and especially at trial, the economists' expert opinions and the economic theories and models that buttress the competing opinions take center stage. However, even for counsel who are experienced in the practice of antitrust jurisprudence, an economist's expert opinion is oftentimes convoluted or difficult to follow. Generally, the economist's opinion will rely on empirical evidence and interpret available quantitative data. In merger cases, economists will use the Herfindahl-Hirschman

[176] Garza, *supra*, n. 166 at 5 ("The 2010 Guidelines, thus better reflect how the agencies actually assess mergers")
[177] *Id.* at 4. ("The 1000 HHI safe harbor has become 1500 and the 1800 threshold has become more than 2500").
[178] *Id.*
[179] *See* Shapiro, *supra*, n. 140 at 708 ("The revised Guidelines emphasize that merger analysis ultimately is about competitive effects.").
[180] *Id*.
[181] Shepard Goldfein and Neal R. Stoll, Back to Basics: The (Over) Use of Economic Models in Antitrust, NYLJ, July 11, 2012, p. 1.

Index (HHI) to measure competitive effects, and rely on models, including the GUPPI (Gross Upward Pricing Pressure Index), the newly discovered vGUPPI (Verical GUPPI), diversion ratios, SSNIPs, and Bertrand behavior, etc.

Somewhat more evolved than the popular freshwater aquarium fish species, GUPPIs forecast post-merger effects by scoring the merger's predicted upward pricing pressure based on an economic model. While this tool and others like it are certainly sophisticated, they can obfuscate and overcomplicate matters over the course of a case. Further compounding the problem is the overwhelming menu of economic suppositions and schools of ideology to which economists subscribe and on which economists base their opinions. The difficulty of using the arsenal of today's advanced economic weaponry is exacerbated by the fact that judges, lawyers and juries often lack the training, judgment, and experience necessary to decide which of the competing economic opinions to credit.

As the heavy lifting in merger cases has been ceded to economists, the role of the courts has diminished.

### B. *Illinois Brick*

In its 1977 decision in *Illinois Brick*,[182] the United States Supreme Court held that only those who purchased directly from antitrust violators -- and not others in the chain of distribution -- are "injured" within the meaning of section 4 of the Clayton Act, thereby barring claims of indirect purchasers.[183] Although the Court recognized that indirect purchasers may well have had overcharges passed on to them and thus suffered injury, the Court ultimately concluded that tracing overcharges through the chain of distribution would unduly complicate antitrust trials and ultimately impair private enforcement.[184] It also expressed a reluctance to transform the courtroom into an economics classroom.[185] The decision set off a storm of protests, but attempts to persuade Congress to overrule *Illinois Brick* failed. Anti-*Illinois Brick* forces then turned to

182 Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).
183 *Id*. at 735-36.
184 *Id.* at 731-72.
185 *Id.*

state legislatures and had some success in legitimizing indirect purchaser suits under state laws.[186]

Nevertheless, many state-based indirect purchaser suits found their way into federal court either through diversity or supplemental jurisdiction. These cases posed a unique challenge to the federal courts. Given the Supreme Court's unequivocal holding that federal courts were ill-equipped to trace overcharges through the distribution chain under federal law, were the federal courts similarly barred from hearing indirect purchaser claims under state law, notably where state law is essentially identical to federal law? Subsequently, the Supreme Court in *ARC America*[187] held antitrust federalism would permit federal courts to entertain these state claims, *Illinois Brick* notwithstanding.

Still, no court has come to grips with the fundamental objection voiced by the Supreme Court in *Illinois Brick* to indirect purchaser claims -- the impossibility of re-creating price/output decision in the courtroom. Allowing recoveries to indirect purchasers is an exercise not in fact-finding but rather in rough justice.[188] That rough justice can be achieved, however, only after accepting a dizzying array of economic assumptions spun by experts, including the dubious assumption that middlemen routinely pass-on to their customers all, or substantially all, of any overcharges incurred. Such attempts at approximation cross the line separating reasonable estimation from speculation, which courts have traditionally eschewed. The better economic view of indirect purchaser cases is that the cost of proving recovery outweighs any benefits that accrue to indirect purchasers-plaintiffs.

[186] *See* e.g. N.Y.G.B.L. § 340 (permitting indirect purchasers to sue under New York's Donnelly Act).
[187] California v. ARC America Corp., 490 U.S. 93, 101 - 02 (1989).
[188] William H. Page, The Limits of State Indirect Purchaser Suits: Class Certification in the Shadow of Illinois Brick, 67 Antitrust L.J. 18 (1999) ("In contrast to the skeptical account of the problem of passing on, the sanguine view, typified by the Illinois Brick dissent, values compensation over deterrence, equity over efficiency and approximation over accuracy.")

### C. Class Actions

Rule 23 of the Federal Rules sets forth detailed criteria for class certification.[189] Under Rule 23(a) the moving party must establish numerosity, commonality, typicality and adequacy of representation.[190] In addition, Rule 23(b) provides that once each of the elements of Rule 23(a) have been met, the movant must show that failure to certify a class may create the likelihood of inconsistent rules;[191] that class certification is necessary to obtain effective injunctive relief;[192] or that common question of law or fact predominate over individual questions.[193]

Since Rule 23(b)(3) was amended in 1966 to broaden the availability of class actions, the vast majority of certification applications have been made under Rule 23(b)(3).[194] The Rule 23(b)(3) criteria are simple: (1) that common questions of law as fact" predominate over any questions affecting only individual members, and (2) that the class action is superior to other available methods for fairly and efficiently adjudicating the controversy"[195] Yet, the courts have encountered difficulties applying this standard.

Class actions have always been controversial,[196] but today they face unprecedented scrutiny in the courts.[197] Concerned that the grant of certification itself puts the defendant in a

---

[189] Fed. R. Civ. P. 23.
[190] Fed. R. Civ. P. 23(a).
[191] Fed. R. Civ. P. 23(b)(1)(A).
[192] Fed. R. Civ. P. 23(b)(2).
[193] Fed. R. Civ. P. 23(b)(3).
[194] J. Douglas Richards and Ben Brown, Predominance of Common Questions – Common Mistakes in Applying the Class Action Standards, 41 Rutgers L.J. 163 (2009) ("For various reasons almost all federal class actions seeking damages must proceed under Rule 23(b)(3) pursuant to which a predominance of common questions must be established.")
[195] Fed. R. Civ. P. 23(b)(3).
[196] *See*, e.g., Van Gement v. Boeing Co., 573 F. 2d 733, 735-36 (2d Cir. 1978), *aff'd*, 444 U.S. 472 (1980):

> Class actions, termed by some as "lawyer's lawsuits", see *Developments in the Law-Class Actions*, 89 Harv. L. Rev. 1318, 1605 (1976), have received a good deal of criticism; and much of this has been directed at the substantial fees awarded to class attorneys. *See*, e.g., *Alpine Pharmacy, Inc. v. Chas. Pfizer & Co.*, 481 F. 2d 1045, 1049-50 (2d Cir.), cert. denied, 414 U.S. 1092, 94 S.Ct. 722, 38 L. Ed. 2d 549 (1973). Terms such as "golden harvest of fees," *Free World Foreign Cars, Inc. v. Alfa Romeo, S.p.A.*, 55 F.R.D. 26, 30 (S.D.N.Y. 1972), "astronomical fees," M. Blecher, Is the *Class Action Doing the Job?* (Plaintiff's Viewpoint), 55 F.R.D. 365, 366 (1972), and "enormous fees," comment, 54 U. Det. J. Urb. L. 598, 611 (1977), are used to describe the allowances which

position where it is forced in high stakes litigation to settle a case irrespective of the underlying merits, courts have insisted on "rigorous analysis" of class issues at the certification stage.[198] In under taking this rigorous analysis, courts now feel free to examine merits issues at the class certification stage, thereby crossing a once impenetrable divide.[199] Now that merits issues are in play at the certification stage, parties have significant incentives to use the class certification phase as a vehicle to preview their cases for the courts. Yet, the appellate courts have provided little guidance on how far the trial courts can delve into merits evidence at the certification stage, while at the same time licensing that practice.[200]

More recently, appellate courts have created additional uncertainty by adding judicial glosses to Rule that raise the bar for certification. One such gloss is that to establish predominance, class plaintiffs must show that all class issues are susceptible to common proof.[201] A second gloss is that certification is improper unless it can be shown that all class members suffered common injury.[202] Certification proceedings have become something of a cottage industry for expert economists as a result class certification proceedings have been transformed into complex minitrials, a practice roundly condemned by the Supreme Court three decades ago.

---

> often run into the millions of dollars. Critics point particularly to over-generous application of the equitable fund doctrine, by means of which massive fees are awarded attorneys with too little regard for the interests of the class members. *See City of Detroit v. Grinnell Corp.*, 560 F. 2d 1093, 1098 (2d Cir. 1977). [Much of] [t]his criticism… is justified…

[197] *See*, e.g., Wal-Mart Stores, Inc. v. Dukes, 131 S.Ct. 2541 (2011); Behrend v. Comcast Corp., 655 F. 3d 182 (3d Cir. 2011), *cert. granted*, 133 S. Ct. 24 (2012). In re Hydrogen Peroxide Antitrust Litigation, 552 F. 3d 305, 310 (3d Cir. 2008); In re New Motor Vehicles Canadian Export Antitrust Litigation, 522 F. 3d 6 (1st Cir. 2008).

[198] *See Hydrogen Peroxide* 552 F. 3d at 309 ("Denying or granting class certification is often the defining moment in class action (for it may sound the "death knell" of litigation on the part of the plaintiffs, or create unwarranted pressure to settle non-meritorious claims on the part of the defendant").

[199] *Id*. at 320; *cf.* Eisen v. Carlisle & Jacqueline, 417 U.S. 156 (1974) (holding that merits issues cannot be resolved at the class certification stage); *see* generally, Joshua P. Davis and Eric Cramer, A Questionable New Standard For Class Certification In Antitrust Cases, 26 Antitrust 31, 32 (Fall 2011) (pointing out the "ambiguity and uncertainty" of the emerging standard).

[200] Davis and Cramer, *supra*, n. 199 at 31-32.

[201] *See* Richards and Brown, *supra*, n. at 194 at 180-184..

[202] *Id*. at 173.

Moreover, since class certification issues regarding predominance and superiority raise essentially legal questions under Rule 23, it is not clear whether economic evidence is either helpful or relevant to the court's certification decision. Under *Daubert,* such evidence must be carefully vetted by the court and excluded of it does not assist the court.[203]

**D. Use of Economic Theory To Fill In The Gaps In Any Factual Record**

As discussed above,[204] neoclassic economic theory is sometimes offered in place of facts as proof of competitive effects of certain conduct. Two well-known antitrust cases utilizing this approach were *Trinko*[205] and *Twombly,*[206] both of which involved motion to dismiss for failure to state a claim upon which relief may be granted. On a motion to dismiss the complaint, unlike a motion for summary judgment where the entire pretrial record is before the court, only the complaint is properly before the court.[207] Yet, by invoking economic theory, the Supreme Court found that neither Bell Atlantic in *Trinko* nor the defendants in *Twombly* had violated the antitrust laws. Thus, in *Trinko* the Court found that it was perfectly reasonable for Bell Atlantic not to share its infrastructure because to do so "may lessen incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities."[208] Similarly, in *Twombly,* the Court found that it was "only natural" (and hence not illegal) for erstwhile regulated monopolists not to comply with the Telecommunications Act of 1996 by making their facilities available to rivals who then would compete with defendants in local phone service.[209]

Using economic theory to fill gaps in the factual record on a motion to dismiss is objectionable on at least five counts. First, it entails assessment of information outside of the

[203] Daubert v. Merrell Dow Pharmarceuticals, Inc., 509 U.S. 579 (1993).
[204] *See supra*, n. 102 and accompanying text.
[205] Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko L.L.P., 540 U.S. 398 (2004).
[206] Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).
[207] Fletch v. Burkhalter, 609 F.3d 1091, 1098 (10th Cir. 2010).
[208] *Trinko*, 540 U.S. at 408.
[209] *Twombly*, 550 U.S. at 568 ("a natural explanation for the noncompetitive alleged is that monopolists were sitting tight, expecting their neighbors to do the same thing"0.

complaint, the only document properly before the court on a motion to dismiss.[210] Second, by effectively licensing fact-finding at the motion to dismiss stage, it usurps the function of the judge or jury at trial.[211] Third, it undermines the fundamental goal of the Federal Rules of Civil Procedure to provide meritorious litigants their day in court.[212] Fourth, the utility of the neoclassical model has been called into question as both its foundational prongs have been under attack. The collapse of financial markets in 2008 has shaken the faith of free market economists in the concept of self-correcting markets.[213] In addition, scholarly research in the field of behavioral economics has challenged the assumption that firms and individuals always behave rationally as profit-maximizers.[214] Neoclassical analysis emphasizes theory based on assumptions.[215] Behavioralists stress facts based on what people actually do.[216] To the extent

---

[210] *Fletcher*, 609 F.3d at 1098.

[211] *See* Robert L. Rothman, Twombly and Iqbal: A License to Dismiss, Litig., Spring 2009 at 1:

> [I]n a particularly troubling sentence, the Court suggests that a complaint must not only be consistent with the claim asserted, but must also exclude "more likely explanations." (quoting *Iqbal*, 129 S. Ct. at 1951).
>
> What, exactly, does that mean? At a minimum, it appears to be a standard that invites district court judges to dismiss cases based on their own subjective notions of what is *probably* true–a determination that apparently can be made based on events outside the four corners of the complaint. For example, in *Iqbal*, the plaintiff–a Pakistani Muslim–sued numerous government officials asserting violation of various constitutional rights, alleging that, following the events of September 11, 2001, he was classified as a "high interst" detainee and held in extremely harsh conditions as a matter of policy based "solely on account of [his] religion, race, and/or national origin, and for no legitimate penological reason." (quoting *Iqbal*, 129 S. Ct. at 1959). Although conceding his allegations, taken as true, are consistent with his theory of being classified as "of high interest" based on race, religion or national origin, the Court nonetheless found Iqbal's allegations of discriminatory treatment implausible.…
>
> Thus, *Iqbal* has the potential to short-circuit the adversary process by shutting the doors of federal courthouses around the nation to large numbers of legitimate claims based on what amounts to a district court judge's effectively irrefutable, subjective assessment of probable success. This is so notwithstanding a complaint containing well-pled factual allegations that, if allowed to proceed to discovery and proved true at trial, would authorize a jury to return a verdict in the plaintiff's favor. *Id*. at 2 (second alternation in original).

[212] *See* Fed. R. Civ. P. 1.

[213] *See* Justin Fox, The Myth of the Rational Market: A History of Risk, Reward and Delusion on Wall Street (2011).

[214] *See* Reeves, supra, n. 17 at 1-4.

[215] *Id.*

[216] *Id*.

that courts embrace economic assumptions, where those assumptions are at odds with the record facts, the results are inevitably going to be suboptimal.  Fifth, when presented with an economic theory that appears logical or even compelling, a court may be tempted to ignore the factual record.  But, economic theory that is at odds with the record facts is not competent proof and reliance on such economic theory could lead to bad outcomes.  In *Whole Foods,* as discussed, the merging parties, arguing critical loss theory, asserted that marginal purchases would turn to conventional supermarkets and thereby thwart any effort by the newly merged entity to raise prices.  However, this theory was inconsistent with Whole Foods own documents, which indicated that customers of the now closed Wild Oats store would shop at Whole Foods.  The trial court, denying the preliminary injunction relied on Whole Foods' theory, despite its inconsistency with the record facts.  The Court of Appeals ultimately reversed, but the case still illustrates the risk of accepting neoclassic economic theory as fact.

As discussed above,[217] the Hart-Scott-Rodino Antitrust Improvements Acts of 1976 and the promulgation of the 1982 Merger Guidelines effectively took merger enforcement out of the court system and into the administrative realm.  Lawsuits challenging mergers today are rare. Indeed, the Supreme Court has not decided a substantive merger case since the *General Dynamics*[218] case in 1974.

Still, the *de facto* move of merger analysis from the courts to an administrative model has not been without benefits.  Merger review has been faster and more cost-effective when done administratively.  Federal dockets would surely have become far more congested if even a small percentage of the mergers consummated in the late 1990's found their way into the court system.

[217] *See supra* , nn. 129-30 and accompanying text.
[218] United States v. General Dynamics Corp., 415 U.S. 486 (1974).

These benefits, however, has come at a steep cost. The influx of economics into antitrust analysis has made antitrust law in general and merger law in particular less accessible not only to the courts but also to businesses and consumers. Without any stream of cases flowing into the court system, merger law has stagnated. Current enforcement policies vary significantly from Supreme Court precedents of the 1960's. The agencies have not relied on *Von's* Grocery or *Brown* Shoe in decades. It may well be that *Von's Grocery* and *Brown Shoe* are bad merger policy and appropriately disowned by the agencies, but neither case has been overruled by the Supreme Court. The existence of these Supreme Court precedents, even if only technically viable, creates confusion. Although few antitrust observers would consider *Brown Shoe* good law, lower courts in significant and relatively recent merger decisions have cited *Brown Shoe* favorably.[219] Adding to that confusion, *Philadelphia National Bank*, decided before *Von's Grocery* and after *Brown Shoe*, is still widely cited by the lower courts and provides that template that most courts utilize in reviewing mergers. Old precedents cannot be tested or discarded unless new cases are brought to challenge them. This has clearly not happened under the administrative model because there are simply too few merger cases in the judicial pipeline to percolate up to the Supreme Court.

Accordingly, today's businesses and consumers cannot look to the courts for guidance on mergers. They are thus left to look to the agencies for the best indication of the law. But, agency "law" is not accessible or at least not accessible in the same way as court created law. First, most reported mergers are cleared and there is no public record detailing why a particular merger was not challenged. Second, when an agency does challenge a merger and the matter is settled in consent decree, the consent decree is not subject to the detailed scrutiny by an appellate

[219] *See*, e.g., FTC v. Whole Foods Market, Inc. 548 F.3d 1028, 1036 (D.C. Cir. 2008); FTC v. Staples, Inc., 970 F.Supp. 1066 (D.D.C. 1997).

court that a trial court decision would face. In short, those who regularly deal with the agencies on merger matters may have a good feel for how the government might react to a merger. Those outside that small group would not.

Nor do the 2010 Merger Guidelines foster accessibility. As noted earlier,[220] the 2010 Merger Guidelines were intended to bring stated agency policy in line with actual agency practices. The Guidelines do now more accurately reflect actual agency practice then prior iterations but the process of merger review remains shrouded in mystery. This is due, in part, to the fact that the data utilized in merger review is so technical and so permeated with complex economic theory that they are of little use to businesses or consumers without an expert economist to translate. It is also due, in part, to the elimination of primary reliance on market screens, which has made predictability of outcomes under to the 2010 Guidelines more difficult.[221] Simply put, the Merger Guidelines are beyond the experience of the very people they were intended to guide, including many lawyers and judges.

Nor are the problems of accessibility, created by the use of economic theory confined to merger law. The Supreme Court while insisting that courts entertain economic evidence has recently given judges and juries a vote of no confidence in managing and deciding Sherman Act cases.[222] *Trinko*, for example, casts doubt on the ability of courts to reach good outcomes in section 2 cases, citing:

1. High costs of false positives.[223] The Court stated that even in the best of circumstances the application of section 2 law “can be difficult.”[224] Mistaken inferences of

[220] *See supra*, n. 176 and accompanying text.
[221] *See* Garza, *supra*, n. 166 at 4.
[222] *Twombly*, 550 U.S. at 559; *Trinko*, 540 U.S. at 414-15.
[223] *Id.* at 414.
[224] *Id*.

anticompetitive effect are "especially costly," because "they chill the very conduct the antitrust laws are designed to protect."[225]

2. Difficulty in evaluating refusals to deal. Courts may not be able properly to evaluate refusals to deal "not only because they are highly technical, but also because they are likely to be extremely numerous, given the incessant, complex and constantly changing interaction "of the parties."[226] Identifying the means of antitrust exclusion may prove a "daunting task" for "generalist" antitrust courts.[227]

3. Costs of litigation. Antitrust enforcement in regulated industries may lead very costly "interminable litigation."[228]

4. Lack of supervisory expertise. The courts are ill-equipped to undertake the task of supervising forced sharing arrangements among competitors on a day to day basis.[229]

Finally, the Court has urged judicial self-restraint, even in those cases where the costs of enforcement do not outweigh the benefits of antitrust intervention because the Sherman Act "does not give judges *carte blanche* to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition."[230]

The upshot of *Trinko* is that antitrust cases involve complicated economic evidence that is difficult for courts to process and precisely because of this reality, courts are likely to make mistakes in deciding these cases. To avoid falsely condemning conduct that is precompetitive, courts should not entertain, i.e., dismiss at the outset, such cases.

---

[225] *Id*.
[226] *Id*.
[227] *Id*.
[228] *Id*.
[229] *Id*. at 415.
[230] *Id*. at 415-16.

## V. Is Antitrust All That Complicated?

Unquestionably, increased reliance on economies by courts and litigants has led to a whole new dimension of complexity in antitrust cases. Nowhere is that more evident than in merger practice under the Merger Guidelines. With SSNPs, UPPs, HHI and diversion ratios, the merger arena has been transformed. Economics no longer *assists* legal analysis; it now *dictates* legal analysis.

### A. Mergers

Is this level of complexity necessary? A recent retrospective study of government mergers by economist John Kwoka suggests that it is not.[231] After analyzing data on the FTC enforcement actions between 1996 and 2007, Kwoka made two observations. First, "the probability of enforcement action is a strictly declining function of the number of significant competitors in the market affected by the merger."[232] Thus in markets involving more than ten significant competitors, there were no enforcement actions.[233] In markets that went from six firms to five, there were enforcement actions 40% of the time.[234] In three to two mergers enforcement actions were initiated in 87% of the cases. In mergers to monopoly, enforcement actions took place in 98% of the cases.[235]

Second, entry conditions are a significant factor in determining the outcome of investigations.[236] Thus in all 36 of the FTC investigations where entry was deemed to be easy, the matters were terminated without enforcement actions.[237] On the other hand, where entry was

---

[231] John Kwoka. Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes, April 2012, available at www.luc.edu/law/academics/special/center/antitrust/pdfs/Kwoka.pdf.
[232] *Id.* at 4.
[233] *Id.* at Table 4.
[234] *Id.*
[235] *Id*.
[236] *Id*. at 12.
[237] *Id.* at *Id*.

viewed as difficult, enforcement actions took place in over 80% of all investigations.[238] Data further show a greater percentage of enforcement actions occur where the HHI is greater, where the change in HHI is greater and where the number of significant competitors is lower.[239]

Kwoka's insight is as remarkable as it is simple. Concentration and entry conditions are the key indicators of the likelihood of enforcement action. That, in turn, suggests that perhaps the Full Monty treatment offered in the Guidelines is not necessary after all.

B. Remember the Vertical Restraint Guidelines?

In 1985, flush with the success of the Merger Guidelines, the Antitrust Division promulgated the Vertical Restraint Guidelines ("VRG").[240] The VRG were designed to provide businesses, consumers and the courts a roadmap to Antitrust Division analysis of a variety of vertically imposed restraints, including resale price maintenance, territorial restraints, tying and exclusive dealing. Like the Merger Guidelines, the VRG were heavily steeped in economic theory; but unlike the Merger Guidelines, the VRG were not well-received. As Robert Pitofsky noted, the VRG were "in effect a conservative brief against antitrust enforcement involving vertical restraints rather than a statement of the law."[241] The VRG's Vertical Restraint Index, a quantitative measure of restraint analogous to the HHI in the Merger Guidelines, was downright silly. Nor did the VRG ever gain traction in the courts. The VRG were subsequently rescinded by the Clinton Administration.[242]

---

[238] *Id.* at *Id*.
[239] *Id.* at *Id*.
[240] Vertical Restraint Guidelines (1985), 4 Trade Reg. Rep. (CCH) par. 13, 105.
[241] Robert Pitofsky, Antitrust Policy in the Clinton Administration, 62 Antitrust L.J. 217, 219 (1993).
[242] Anne K. Bingaman, Change and Continuity in Antitrust Enforcement, Remarks before the Fordham Corporate Law Institute, Fordham Law School (Oct. 21, 1993) (transcript available at < http:// www.usdoj.gov/atr/public/speeches/93-10-21.txt>) (noting that the VRG were "controversial from the outset" and that "they unduly evaluated theory over factual analysis and in certain respects were at variance with existing case law").

The lesson from the VRG experience is that courts (and juries) can reach reasoned outcomes in antitrust cases, including merger cases without reference to complicated quantitative tests. Even if one were to accept that notion that antitrust cases as a group are inherently complex, that does not mean that antitrust issues cannot be resolved by judges and juries. Indeed, the jury trial is a fundamental feature of American jurisprudence and expressly authorized in private damage actions by the Clayton Act.[243] Notwithstanding the clear right to a jury trial in antitrust cases, some have argued that antitrust cases are simply too complicated for juries and that jury trial demands in such cases should be stricter. Although the Supreme Court has never addressed this issue directly, only the Third Circuit has recognized such an exception.[244] Still the argument, now fueled by *Twombly* and *Trinko*, persists; but it remains unpersuasive. The complexity exception is both unwise and unnecessary.[245] Some antitrust issues are indeed complex, but it is the job of the advocate package the case is a way that is understandable to jurors. This can be done in a variety of ways.[246] Attorneys can take advantage of technology and provide visual aids through power point and video presentations to highlight significant documentary and testimonial evidence.[247] The Federal Rules of Civil Procedure provide for bifurcating liability and damages issues and also permit interrogations to the jury to facilitate their deliberations.[248] In addition, the Manual for Complex Litigation provides a variety of trial management techniques to streamline the presentation of the case.[249] Moreover, simple, common sense practices, such as permitting the jurors to take notes, allowing jurors to question witnesses, providing jurors with glossaries of terms of art and exhibit books,

[243] 15 U.S.C. § 15.
[244] *In re* Japanese Electronic Products Antitrust Litigation, 631 F. 2d 1069, 1086 (3d Cir. 1980).
[245] *See Brooke Group*, 509 U.S. at 243 ("a reasonable jury is presumed to know and understand the law, the facts of the case and the realities of the market.")
[246] *See* John F. Grady, Trial Management and Jury Control in Antitrust Cases, 51 Antitrust L.J. 249 (1982).
[247] *Id*. at 254.
[248] Fed. R. Civ. P. 42(b), 49.
[249] Manual For Complex Litigation (Fourth Ed. Federal Judicial Center 2004).

minimizing in-court objections and side-bars, and authorizing intermediate summations by counsel serve to enhance the quality of jury verdicts.[250] In short, with the right tools, jurors are fully capable of reaching good results.

Even if it were true that some antitrust cases were too complex for juries, the answer to that problem would not to leave matters up the judge. As a matter of logic, if issues are too complicated for juries, they may also be too complicated for judges. As the law now stands, there would be no other body to hear and determine complex antitrust cases. That, in turn, would suggest that at least some antitrust cases are inherently not justiciable. Given the enactment of the antitrust laws and Congress's clear mandate that the courts enforce these laws, that outcome must be rejected out of hand, despite the push in that direction by *Twombly* and *Trinko*.

Finally, the role of the jury in all cases, including antitrust cases, is to bring the common sense of the community to bear on the factual issues before it. However, when the jury is bombarded with expert economic evidence, its verdict is less about bringing in the common sense of the community to decide the issue and more about choosing between the views of the plaintiff's expert and the views of the defense expert. The courtroom is then transformed into an intermediate microeconomic classroom, precisely the scenario that the Supreme Court in *Illinois Brick* sought to avoid. It is not important for the jury to decide which of two competing economic models best describe a particular marketplace. More important is that the jury apply good judgment to the facts before it.

C. Structured Rule of Reason

In Sherman Act cases, the courts should strive to develop rules that are clear, predictable and easy to administer as an alternative to the *Chicago Board of Trade* approach, which invites a broad, open-ended inquiry into market conditions and business behavior. That freewheeling

[250] *See* Grady, *supra*, n. 246 at 252-54.

mode of analysis inevitably drives up litigation costs, complicates issues and renders outcomes less predictable. These undesirable side effects could be avoided by implementation of a structured rule of reason. The Court of Appeals decision in *Three Tenors*[251] could serve as a template:

> We therefore accept the Commission's analytical framework. If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm. That much follows from the caselaw; for instance, in NCAA the Court held that a "naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." Similarly, in IFD, the Supreme Court ruled a horizontal agreement to withhold services could not be sustained because the dentists failed to advance any "credible argument" that "some countervailing precompetitive virture … [redeemed] an agreement limiting consumer choice by impeding the 'ordinary give and take of the market place.'"[252]

Alternatively, courts could strike down those restraints that have been imposed despite the existence of a less restrictive alternative.[253] The point is that endless sifting of market data and economic analysis is not necessary in order to reach a reasoned decision in Rule of Reason cases.

In the section two realm, the *Microsoft*[254] approach provides a court-friendly roadmap to analyzing monopolization cases.

1. Determine whether defendant has monopoly power.

2. Determine whether defendant has committed bad acts;

3. Once the plaintiff establishes market power plus bad acts, the burden shifts to the defendant to come forward with precompetitive justification for its conduct;

[251] Polygram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005).
[252] *Id*. at 36.
[253] *See* Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1, 33 (Stevens, J. dissenting).
[254] Microsoft Corp. v. United States, 253 F.3d 34 (D.C. Cir. 2001).

4. Absent any justification or asserted justification that is mere pretext, the defendant will be held liable under section 2;

5. If the defendant's conduct has true precompetitive benefits, then the defendant would be liable only if the anticompetitive effects outweigh the precompetitive benefits.[255]

This analytical process involves the exercise of traditional judicial functions with a minimum reliance of economic theory.

## Conclusion

In an admirable attempt to achieve good outcomes, courts have embraced economic theory to an unprecedented extent. The result has been a more complicated, less predictable body of law which is evermore costly to litigate in the courts. This is a far cry from what Congress had in mind enacting the Sherman Act and the Clayton Act. Courts need to re-think the role of economics in antitrust litigation and restore the balance between fact and economic theory to produce rules that are clear, predictable, administrable and just.

[255] *Id.* at 50-59.