Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *In this issue, we offer three notes on recent papers. The first discusses Christopher Leslie's analysis of the role of trust in facilitating cartels and the role of antitrust in undermining it. The second discusses Marina Lao's critique of today's* Noerr *doctrine. The third discusses Alan Meese's proposal of a property rights theory of intrabrand restraints. All three of these articles suggest that the reader revisit, and perhaps reconsider, some common concepts about commercial behavior that is subject to the antitrust laws. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

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Papers and Summaries

Christopher R. Leslie, Trust, Distrust, and Antitrust, 82 *Texas L. Rev.* 515 (2004).
In this massive article (165 pages, 1130 footnotes), Professor Leslie of Chicago-Kent analyzes the role of trust among conspirators in the formation and operation of cartels, and the role of antitrust enforcement in sowing distrust. He begins with a lucid discussion of the Prisoners' Dilemma as a model of the cartel problem, under plausible assumptions, with cheating as the dominant strategy for cartel members. He then shows that trust—the willingness to make oneself vulnerable to the actions of another—can solve the dilemma by facilitating cooperation, a substitute for a binding contract among the conspirators.

Leslie identifies a variety of sources of trust: communication, reputation, social norms, and ethnic and class homogeneity. He then surveys studies of over fifty cartels, from the Kanawha salt cartel in the 19th century up to the lysine and Sotheby's cartels of the past decade. In this portion of the article, Leslie identifies the ways distrust undermines cartels and how trust may facilitate them. For example, distrust leads cartels initially to charge prices lower than those of a profit-maximizing monopoly, in order to forestall cheating. Cartel members may, however, foster trust by forging personal relationships, making goodwill gestures (like generous market share allocations), enhancing transparency in cartel dealings (e.g., by price-reporting mechanisms and standardization), communicating frequently, and building cartel-friendly social norms (mainly through trade associations). As an example of cartel ethics, Leslie reports that members of the Kanawha salt cartel swore on a Bible to stick to the cartel price. In addition, cartels have sought members from the same social class. In an especially interesting section, Leslie describes how experience in a successful cartel in one market can be extended to other markets by a process of "cartel creep." He also describes a variety of cartel substitutes (such as government regulation) and a variety of mechanisms for detecting and punishing cheaters.

Having shown how trust facilitates cartels, Leslie shows how antitrust undermines trust and thus fosters cheating. The discussion almost exactly mirrors the preceding one, showing, for example, how antitrust impedes transparency and communication and builds anti-cartel norms. Leslie then discusses how antitrust (particularly the DOJ leniency program) promotes another form of defection from cartels: whistle-blowing to the authorities.

In a final section, Leslie makes a number of suggestions based on the insights of his study. For example, he suggests increasing cartel penalties and the rewards for confessing. In a particularly intriguing discussion, he points out the danger of "cartel blowback" from governmentally approved

cooperation among rivals. He notes, for example, that cartels formed under the auspices of the NRA during the New Deal provided reservoirs of trust that facilitated later illegal cartels. More controversially, he suggests that joint ventures between rivals should be viewed with greater suspicion, in spite of any productive efficiencies, because they may foster trust between the participants. Leslie acknowledges the danger of overdeterrence in this suggestion.

Finally, Leslie suggests how his study might indicate the need for reevaluation of a variety of practices in cases requiring inference of a conspiracy. He argues that trust-building measures of various forms, and the participation of members with cartel experience, should be viewed as weighing more heavily toward inference of an agreement.

Marina Lao, Reforming the *Noerr-Pennington* Antitrust Immunity Doctrine, 55 *Rutgers L. Rev.* 965 (2003).
In this article, Professor Lao of Seton Hall argues the courts have interpreted *Noerr* petitioning immunity too broadly to encompass any effort to influence any governmental entity, whether legislative, judicial, executive, or administrative. Moreover, cases like *Omni Outdoor Advertising* and *Professional Real Estate Investors* have interpreted the sham exception to *Noerr* immunity too narrowly to cover only those petitions that are objectively baseless (under stringent standards), *and* subjectively intended to harm a competitor through governmental process rather than the outcome of the process. Lao argues that business efforts to influence government action pose particularly significant threats to competition, and that not all of them implicate the First Amendment policies underlying *Noerr*. For example, while efforts to mislead legislatures might warrant some First Amendment protection because of the need for unfettered debate, efforts to mislead courts or administrative adjudicators in their more focused factual inquiries would not. Many legal provisions (e.g., Rule 11) already prohibit baseless factual and legal representations to courts; antitrust law should not extend protection to misrepresentations either.

Lao proposes narrowing the scope of petitioning immunity to cover only efforts to persuade governmental actors to take discretionary action, for example, by denying a certificate of need to a competitor in a regulated market. The immunity should not cover submissions that merely trigger ministerial governmental acts, such as filings of drug patents with the FDA for inclusion in its Orange Book. She also proposes that the courts recognize a fraud and misrepresentation exception to *Noerr* that is independent of the sham exception. She notes that *Walker Process* already recognizes an exception from the antitrust patent immunity for infringement suits based on patents obtained by fraud on the Patent Office. These suits would not be covered by the present sham exception to *Noerr* immunity, because the patent application genuinely sought the patent—it was not merely sought to disadvantage competitors by a governmental process. Lao argues that the principle of *Walker Process* should be extended to except from *Noerr* protection petitioning based on fraudulent representations that are "material" to the proposed governmental decision.

Finally, Lao proposes expanding the sham exception in two ways. First, she suggests that a suit should be considered objectively baseless if a litigant could not reasonably expect to win on the merits. Second, she suggests that the requirement of subjectively bad intent be dropped for cases of allegedly sham litigation.

Alan J. Meese, Property Rights and Intrabrand Restraints, 89 *Cornell L. Rev.* 553 (2004).
In another of his reconceptualizations of antitrust law, Professor Alan Meese of William & Mary argues that intrabrand restraints are best understood as efforts to grant dealers property rights in

the information they create to promote the manufacturer's goods. The property rights explanation accepts the widely shared view of contemporary economists that intrabrand restraints induce dealers to provide an optimal level of point-of-sale services, but offers, Meese argues, a more complete explanation of how the restraints accomplish this goal.

In his classic article, *Why Should Manufacturers Want Fair Trade?* (1960), Lester Telser suggested that intrabrand restraints, like resale price maintenance, foster nonprice competition in point-of-sale promotional services by eliminating free riding by discounters. Benjamin Klein and Kevin Murphy, however, argued in *Vertical Restraints as Contract Enforcement Mechanisms* (1988), that Telser's account did not explain why nonprice competition would necessarily produce the optimal level of services. Dealers could evade the restrictions by secret discounts of various forms, or simply consume the excess profits. Instead, Klein and Murphy suggest that the protections provided by intrabrand retraints function as a performance bond that the dealer will forfeit if the manufacturer finds that the dealer is not performing the point-of-sale services the manufacturer wants. Those services might include non-promotional services, like maintenance of freshness standards.

Both of these accounts assume the manufacturer uses intrabrand restraints to induce dealers to provide a known list of preferred point-of-sale services, just as a vertically integrated firm might direct its employees to provide the same services. But this sort of planning involves gathering local information, a process that the manufacturer, as a centralized planner (analogous, in some ways, to a socialist planning board), may not be best situated to accomplish at the optimal cost. Meese argues that resale price maintenance differs from vertical integration by fostering decentralization in decisions about appropriate point-of-sale services. It does this by conferring on dealers a kind of property right in promotional information, which provides the incentive to provide optimal services. Recognizing this characteristic of intrabrand restraints supports Telser's account by identifying the mechanism by which the restraints promote optimal dealer services.

The sale of the product to the dealer transfers property in the goods, with the right to capture the returns from sales to any customers the dealer can find and persuade to buy. But free riding by rivals can undermine the dealers' incentives to capture the value created by the sellers' promotional efforts. Vertical restraints allow the manufacturer to adjust the dealers' incentives by protecting the property rights of the dealers in their promotional information, and thus in the returns from their promotional investments. Thus, the manufacturer retains the benefits of competition and decentralization in distribution. According to Meese, "Once in possession of a property right, a dealer would determine how best to exploit the right in question, given the dealer's unique knowledge, capabilities, and assessment of local consumers' preferences."

This view of vertical restraints provides an answer to those who argue that such restraints limit dealer freedom to make key choices. The point of vertical restraints, Meese argues, is to enhance, not restrict, dealer autonomy. By conferring property rights, they restrict "freedom," but only to the extent that all property rights do:

> The alternative—a war of all against all for whatever resources individuals can capture—would replicate the tragedy of the commons throughout society. Market-based competition requires property, including property that parties create by contract. Courts have long recognized that contracts are not suspect merely because they eliminate rivalry that would otherwise have occurred. Recognition of property, including property created by contract, does not constitute improper administration in any economically meaningful sense.

Thus, the failure of the manufacturer to prescribe specific promotional activities is not an indication that the restraint is not aimed at fostering optimal services. ●