

## Paper Trail: Working Papers and Recent Scholarship

*Editor's Note:* In this edition, we note a working paper that examines what form of organization is best suited for providing sound recommendations by economists to agency decision makers, and another that uncovers an emerging definition of concerted agreement in the post-Twombly pleading standards case law that focuses on communication among rivals. Send suggestions for papers to review, or comments, to: [page@law.ufl.edu](mailto:page@law.ufl.edu) or [jwoodbury@crai.com](mailto:jwoodbury@crai.com).

—WILLIAM H. PAGE AND JOHN R. WOODBURY

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### Recent Papers

#### **Luke Froeb, Paul A. Pautler, and Lars-Hendrik Röller, The Economics of Organizing Economists (Vanderbilt Law and Economics Working Paper Number 08-18)**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1155237](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1155237)

This short paper is not about unionizing economists (which would probably be futile in any event), but about organizing economists within the agencies—what form of organization is best suited for providing sound recommendations by economists to agency decision makers, whether they be the FTC commissioners, the FCC commissioners, or the Assistant Attorney General for Antitrust. The authors are certainly well positioned to consider that issue—Froeb spent time as Director of the FTC's Bureau of Economics and as a key staffer at the Justice Department; Pautler is a long-time member of the Bureau's front office, and Röller was the first Chief Competition Economist for the European Commission.

The focus of the paper is on how to best integrate the economic and legal analysis performed at the agencies. But the paper also reflects an underlying current of past and present tension between economists and lawyers at the agencies. So in a sense, the underlying question is whether economists and lawyers can ever just get along. A long note 16 in the paper describes how this tension has existed for at least the past forty years or so. It concludes that debates about the relative value of economists and lawyers “will likely never end so long as a substantial number of each profession remains at the agency.” And our big disadvantage at the agencies (speaking, of course, as an economist) is that we are seriously outnumbered.<sup>1</sup> In any event, this paper assumes that agency decision makers are interested in implementing the most efficient way of providing economic advice to them, but that a difference in views between economists and lawyers affects the costs and benefits of different organizational forms.

The first sentence of the paper begins by noting that in February of this year, the Swedish Competition Agency abolished its Department of Economic Analysis, dispersing the economists

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<sup>1</sup> I am surprised that the authors didn't discuss more explicitly whether and the extent to which differences in incentives between the agency's lawyers and economists contribute to these tensions. It may well be that the agency lawyers have greater incentives than agency economists to litigate (because litigation increases the value of lawyers to outside law firms more than it increases the value of economists to academia, consulting firms, or law firms).

to the various legal divisions. I suspect that upon reading that first sentence, many if not most economists would immediately have felt a disturbance in the force, concluding that such a move signals the end of days for economic analysis at the Swedish Competition Agency. While this paper manages to maintain a balanced analysis of a centralized vs. a decentralized role for economic analysis, the discussion almost inevitably leads to the conclusion that such fears are justified.

The paper briefly describes the organizational evolution of the economists at the FTC and the Antitrust Division. Particularly interesting are the swings in the FTC's organization chart. The paper also describes the changed organizational role of economists in the EC with the appointment of a Chief Competition Economist with his own staff. As I note below, this discussion is all too brief.

Against that background, the paper compares two organizational models. The "functional" model is one that assigns economists to a single unit, such as the FTC's Bureau of Economics and the Antitrust Division's Economic Analysis Group. The second is the "divisional" model, which assigns economists to enforcement divisions or sections headed by lawyers, such as the change in organization that apparently occurred in Sweden. Arguably, this is the model currently in vogue at the FCC.

The paper relies on an organizational textbook to characterize the advantages and disadvantages of each, but I think that was probably unnecessary baggage for their discussion. These authors don't need a text to validate their characterizations.

One key advantage of the functional model is specialization. EAG and BE can "afford" to hire theoretical and empirical specialists (e.g., for demand estimation and merger simulation) because they can be used across a wide variety and a large number of different matters.

A second advantage is in the recruitment and retention of economists. For economists, there is an "academic" flavor to life at EAG and BE—agency economists are expected to demand rigor in analysis, to be familiar with modern analytic tools, and to freely criticize the work of colleagues to better identify the shortcomings of any particular case theory or approach (as well as to maintain the quality of analysis). That academic flavor, in turn, facilitates the hiring of new, high-quality Ph.Ds and keeps experienced and stellar veterans interested in working for the agencies, and facilitates the hiring of nationally prominent economists to serve as the leader of the group of economists. The new hires would be coming into an environment that shares lots of attributes with their previous academic life.

Two other advantages of the functional form are worth noting. One is that the extent of quality control over the work of the agencies' economists will be substantial—the work of the staff economists is overseen by other economists whose reputation and credibility will fall with shoddy analysis. So, in this sense, there is an alignment of incentives between the staff and their supervisors. In addition, the authors argue that the functional mode encourages innovation because "innovation in antitrust enforcement is driven largely by advances in economic learning . . . as economists apply and develop methodological innovations to the problem of enforcement." (p. 12) I generally agree with this point, although I'm not sure that all lawyers would agree that innovation is so one-sided. After all, innovation in the economics of antitrust usually must be supported by innovations in enforcement policy and in court decisions.

The paper describes the "main disadvantage" of the functional approach as a tendency to focus on narrower economic issues as opposed to addressing issues that are of critical importance to decision makers, "probative questions, like market delineation, whose answers might be crucial to the enforcement decision." (p. 6) I'm somewhat surprised by this particular example. Economists for years have argued that market definition is only a tool for evaluating competitive effects. If an economist were to exert much more effort on market definition rather than on com-

petitive effects, the risk of enforcement error could be substantial. And, in my experience, lawyers have become more accepting of this view, particularly during the merger review process. But certainly, there may be times when economists become fascinated with one particular aspect of the case in order to try new theories and methodologies rather than having a laser-like focus on the central competitive issues or the legal issues required for a successful court challenge.

In any event, focusing on and analyzing issues of concern to the lawyers is a key “advantage” of the divisional model, where economists work as a team with the lawyers. Nonetheless, the authors are quick to point out that “by framing the questions for the economists, the attorney managers also risk [pre-]determining the answers.” (p. 15)

The divisional approach also promises faster decision making because it would eliminate the “need” for multiple recommendations on the disposition of any particular matter. But again, the authors are quick to note that the decision makers then never see any substantial difference in either fact interpretation or in how those facts are translated into competitive effects because those disputes are resolved before a recommendation is made to the decision maker. Even if the divisional model didn’t preclude economists and lawyers from making separate recommendations, it’s unlikely that a lawyer-manager would be able to exercise the same degree of quality control as an economist-manager. And there are too few lawyers who also have advanced economics training to serve as effective quality-controllers, although there are many lawyers who understand and appreciate our expertise.

It’s no surprise that in an either-or world, the paper seems to lean towards the functional approach while encouraging exploration of greater cooperation with lawyers. The paper does mention the “hybrid” EC approach, where some economists work within enforcement divisions and others work directly for the Chief Economist and are assigned to the case teams. It also mentions relatively recent efforts at the FTC to better align the case analysis of economists and lawyers.

This is a worthwhile paper because it deals with issues that are at the heart of the role of economists at the agencies. I would like to have seen how (in the authors’ view) the various organizational changes within the DOJ and the FTC affected the voice of the economists. And it would be useful if the authors expanded the discussion of the EC approach in particular as a way of bridging the “focus” gap between the functional and divisional models, and the efficacy of that approach.<sup>2</sup>

I am surprised that the paper doesn’t ask whether any market tests would indicate which approach is more efficient. In particular, my impression is that there are very few “in-house” economists at law firms—they rely on outside consulting firms that specialize in economics. To be sure, there may be greater incentives by the consulting firm economists to avoid being distracted by ultimately irrelevant matters, but I think the analogy between specialized expertise in the consulting firm and the functional approach is largely intact. The market test suggests that the functional approach is the more efficient.<sup>3</sup>

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<sup>2</sup> Let me note in passing that arguably, the EC model is close to the FCC model. While there are economists who work within the various FCC bureaus (e.g., Wireline, Wireless, and Media), there is also a separate, independent “division”—the Office of Strategic Planning and Policy Analysis—that houses both the Chief Economist of the FCC and other economists. My understanding is that these economists are involved in major case work.

<sup>3</sup> My editor-colleague Bill Page reminds me that the agency economists (and attorneys) do more than prepare for litigation—they also advise decision makers on broad policy questions, such as revisions to the Merger Guidelines and what Section 2 means for antitrust oversight, and they conduct research into broad antitrust questions, such as tying and bundling. These other non-case focused activities do limit the scope of my market-test, which is all case-focused. But case-related activities do encompass much of the work of agency staffs and so I think the analogy is still meaningful. While the paper doesn’t make a distinction between litigation-focused and policy-focused advice to decision makers, I suspect that adding the policy-focused dimension would be an even more compelling reason for a functional approach.

Finally, the importance of organization to the voice of economists needs to be evaluated in the context of other factors. The paper observes that “the optimal [organizational] form depends on what you want your economists to do. If the answer is ‘not much,’ then either of the organizational forms . . . would work well. Either make the economists report to an attorney who does not appreciate economic analysis; or isolate economists within their own bureau, with few links to the attorneys.” Put differently, the disciplinary biases of the decision makers can play a key role in how economists are used. One who appreciates economic analysis will set cues that work to elevate the role of economists in case analysis; one who doesn’t will set cues that will discourage their use. And in my experience scattered over more agencies than I care to count, it is that decision maker who has the greatest impact on amplifying or muting the economists’ voice.

—JRW

**William H. Page, *Twombly* and Communication: The Emerging Definition of Concerted Action Under the New Pleading Standards**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1286872](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1286872)

In *Bell Atlantic Corp. v. Twombly*,<sup>4</sup> the Supreme Court required plaintiffs alleging a Sherman Act agreement to plead more than conscious parallelism and an unspecified “conspiracy.” Under *Twombly*, plaintiffs must now plead sufficient facts to make it plausible to infer that the defendants formed an unlawful agreement. Interestingly, however, the Court did not explain what sort of conduct distinguishes concerted action from consciously parallel action. In this article, I examine nineteen federal court decisions applying the *Twombly* standard. I argue that these cases, explicitly or implicitly, apply a definition of agreement that focuses on communication among rivals.

Oligopolists can, under certain conditions, set a noncompetitive market price by consciously parallel conduct. If there are four gas stations at the same corner in a remote town, for example, one station might increase prices in hopes that the others would follow suit; the others might keep prices low and increase their sales, but they also might choose to match the higher price. If they choose the latter course, they have arguably formed a kind of agreement: the first price increase is an offer and the others are acceptances. Thus, so far as the literal language of the Sherman Act is concerned, this scenario could amount to an unlawful agreement in restraint of trade.

The scenario would also seem to meet the Supreme Court’s traditional definitions of a Sherman Act agreement—a “conscious commitment to a common scheme” or “meeting of the minds.” The courts, however, have come to agree with Donald Turner’s argument that, in scenarios like this, the rivals have not agreed within the meaning of Section 1 because they have done nothing culpable (they have only taken account of each other’s likely actions) or regulable (courts could not enjoin the conduct without direct price regulation).

The courts first reached this result in formulating standards for summary judgment in antitrust cases. Under *Matsushita*,<sup>5</sup> to avoid summary judgment, a plaintiff must produce evidence that tends to exclude the possibility that the defendants were engaging in mere consciously parallel conduct. The plaintiff must offer a “plus factor,” that is, some evidence that is consistent only with agreement. *Twombly* reached a comparable result in framing its pleading standard. Although the Court did not require the plaintiff to plead a plus factor, it did require the plaintiff to plead

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<sup>4</sup> 127 S. Ct. 1955 (2007).

<sup>5</sup> *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

“grounds,” “context,” “circumstance,” or “fact” sufficient to make a claim of agreement “plausible.” The Court justified its standard by its fear of the costs of discovery: “it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no reasonably founded hope that the [discovery] process will reveal relevant evidence to support a § 1 claim.” Significantly, however, the Court in *Twombly* offered no new guidance on the nature of a Sherman Act agreement.

I have argued elsewhere<sup>6</sup> that the lower federal courts, in deciding under *Matsushita* whether to grant summary judgment, have moved toward a definition of agreement that focuses on communication among rivals. I suggested that this trend is consistent with the definition of agreement proposed by Oliver Black:<sup>7</sup> in conscious parallelism, firms share a common goal and act in pursuit of that goal, relying on one other to do the same; the firms’ actions become concerted if they achieve the goal in part by communication of their intent and reliance. I argue that communications are more likely to meet these conditions if they are private and repeated. This definition is not compelled by economic theory, but it is consistent with the views of most informed antitrust economists that communications are essential to any successful cartel.

In the present article, I argue that the nineteen post-*Twombly* pleading cases reveal a similar focus on communication. The cases do not hold that the plaintiff must specifically plead communication. *Twombly* itself suggested that it might be possible to plead an agreement by alleging “complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other discernible reason.” This passage suggests that there may be scenarios so unusual that they could only be explained by inferring that the defendants communicated among themselves. In practice, however, only one post-*Twombly* case upheld a complaint on this ground, and that one appears to be inconsistent with *Twombly*.<sup>8</sup>

Most of the cases in which the plaintiffs failed to allege communications held that the defendants each had reason to act as they did regardless of what course their rivals took. Other cases recognized that the defendants’ actions only made sense if all of them acted in the same way, but hold that the defendants could have achieved the result by interdependent conduct. In the *Travel Agent* litigation,<sup>9</sup> for example, the airlines had successfully, by parallel actions, reduced the commissions they paid travel agents for ticketing. The court concluded that these actions were explicable as consciously parallel conduct. It quoted with approval the deposition testimony of one airline executive who admitted that his airline’s cut in commissions could only have succeed if the other airlines matched it. He went on to say however, that “[a]ll I care about is how people behave if I do something or how I believe if they do something. To me that’s not consensus. That’s taking a common action after the fact which is to me a lot different than consensus.”

Most plaintiffs alleged communications, but not all the complaints that did so were found to be sufficient. Some communications, like those that normally occur in a trade association, were considered benign. Moreover, the courts treated bare allegations that the defendants held “secret

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<sup>6</sup> William H. Page, *Communication and Concerted Action*, 37 LOYOLA UNIV. CHI. L.J. 405, 411–12 (2007); William H. Page, *Facilitating Practices and Concerted Action Under Section 1 of the Sherman Act*, in ANTITRUST LAW AND ECONOMICS (Keith Hylton ed., forthcoming 2009).

<sup>7</sup> OLIVER BLACK, CONCEPTUAL FOUNDATIONS OF ANTITRUST 185–87 (2005).

<sup>8</sup> *In re Pressure Sensitive Labelstock Antitrust Litig.*, No. 3:03-MDL-1556, 2008 WL 2563358 (M.D. Pa. June 24, 2008). The court appeared to assume that the alleged conduct plausibly suggested an agreement simply because it was only profitable if all of the defendants acted in the same way. But that condition is fully consistent with interdependence.

<sup>9</sup> *In re Travel Agent Commission Antitrust Litig.*, No. 1:03 CV 30000, 2007 WL 3171675, at \*10 (N.D. Ohio Oct. 29, 2007).

meetings” as too vague to raise the necessary inference. Courts generally required plaintiffs to allege the circumstances and the content of the communications with some specificity.

The courts’ preference for specific allegations of secret communications seems troubling because that kind of information is normally within the control of the defendants. This result seems to confirm the fears of the dissent in *Twombly* that antitrust plaintiffs may lose on the pleadings under the Court’s new standard because they cannot use discovery to acquire the information they need to plead the agreement with adequate specificity. Interestingly, however, many of the post-*Twombly* cases—like the *Travel Agent* litigation mentioned earlier—did allow some discovery on the merits before resolution of a motion to dismiss for failure to state a claim. I argue that narrowly focused discovery in aid of pleading is appropriate as means of mitigating the possible harshness of the courts’ insistence on communications. ●

—WHP