Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *We review an article that challenges the Easterbrook analysis of the rationality of the defendant's alleged conduct as a basis for judging the plausibility of the plaintiff's allegations and supporting evidence, and argues that judges are ill-suited to that task. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

—William H. Page and John R. Woodbury

Recent Papers

Christopher R. Leslie, Rationality Analysis in Antitrust, 158 U. Pa. L. Rev. 261 (2010)
http://www.pennumbra.com/issues/pdfs/158-2/Leslie.pdf

In this article, Christopher Leslie of the University of California Irvine School of Law takes aim at one of the most common features of modern antitrust analysis: the judicial assessment of the rationality of the defendant's alleged conduct in order to judge the plausibility of the plaintiff's allegations and supporting evidence. If alleged conduct would be irrational for a profit-maximizing firm, then the allegation is implausible, and thus may be subject to dismissal on the pleadings, summary judgment, or judgment as a matter of law. This style of analysis is closely associated with Frank Easterbrook. For example, in his often-cited 1984 article, *The Limits of Antitrust*,[1] Easterbrook criticized the plaintiffs' predatory pricing claim in the *Japanese Electronic Products* case, which the Supreme Court was then reviewing.[2] He argued that the Japanese electronics manufacturers could not have been engaging for decades in below-cost cartel pricing, as the plaintiffs alleged, because they could not realistically have expected to recoup their losses by reaping cartel profits after American manufacturers succumbed. For such a plan to work, the period of cartel pricing would also have to last decades. But to expect a cartel to succeed that long would be irrational because there were no significant entry barriers and cartels are unstable: "The predation-recoupment story therefore does not make sense," Easterbrook concluded, "and we are left with the more plausible inference that the Japanese firms did not sell below cost in the first place. They were just engaged in hard competition."[3]

The Supreme Court accepted this line of analysis in *Matsushita*, concluding that "in light of the absence of any rational motive to conspire, neither petitioners' pricing practices, nor their conduct in the Japanese market, nor their agreements respecting prices and distribution in the American market, suffice to create a 'genuine issue for trial.'"[4] Leslie argues that the influence of this

1 Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1 (1984).

2 *In re* Japanese Elec. Prods. Antitrust Litig., 723 F.2d 238 (3d Cir. 1983), *petition for cert. filed sub. nom.* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 52 U.S.L.W. 3921 (U.S. June 7, 1984) (No. 83-2004).

3 Easterbrook, *supra* note 1, at 27.

4 Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986).

approach on antitrust, especially the law of predatory pricing and horizontal conspiracy, has been mostly pernicious. Firms, he argues, often undertake conduct that appears to be irrational. In some instances, the conduct is irrational because of cognitive biases. Businesses, for example, are influenced by sunk costs that they have incurred, and are often overconfident of the success of new ventures. In other instances, conduct may only appear to be irrational to outsiders who misconceive the firm's real goals or the mechanism of its strategy.

Judges, Leslie argues, are ill-suited (at least for now) to analyze the rationality of firms' alleged conduct. First, they have no experience in business. They are also unaware of the latest developments in post-Chicago economics, which show that conduct that appears to be irrational may be a rational means of pursuing an inefficient goal. Firms may, for example, undertake practices that appear to be irrationally aggressive specifically to establish a reputation for being crazy: "It is rational for a firm to engage in predatory pricing and take a disproportionately greater loss than the firms that it is targeting so long as the firm believes that it will be able to recoup these profits once it establishes a credible reputation as a predator."[5] Such a reputation may deter potential entrants themselves or the venture capitalists that might have financed them.

Judges may also misinterpret business conduct because they fail to recognize that firms (especially foreign firms) may have goals other than profit maximization. Judges may also not take account of the limited information on which businesses must act. The Supreme Court in *Matsushita*, for example, found predatory pricing claims implausible because success was uncertain. But most business ventures are uncertain of success. Firms may nevertheless undertake risky ventures, in some instances because of their confidence (or overconfidence). Finally, judges seem to be prone to cognitive biases in antitrust cases. Leslie sees hindsight bias ("failing to recognize that alleged anticompetitive behavior may have been rational at its conception even though it failed when implemented"[6]) in *Matsushita*'s assertion that the "alleged conspiracy's failure to achieve its ends in the two decades of its asserted operation is strong evidence that the conspiracy does not in fact exist."[7] He also sees confirmation bias (looking for and overvaluing evidence that tends to confirm one's belief system) in the *Baby Food* price-fixing case,[8] in which the court of appeals underestimated the probative value of the defendants' repeated communications about future price moves.

The heart of the article is an extended critique of the modern antitrust law of predatory pricing and conspiracy. Leslie criticizes *Brooke Group*'s determination that it would have been irrational for Brown & Williamson to plan to recoup its losses from below-cost pricing in the generic segment of the cigarette market by a period of tacit price coordination.[9] For example, Leslie objects to the Court's central determination that the price increases in generic cigarettes following the price war did not "permit an inference of a collusive market dynamic [because] rising prices are equally consistent with growing product demand."[10] This reasoning, according to Leslie, was inconsistent

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[5] Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. Pa. L. Rev. 261, 298 (2010). Leslie does not cite *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005), which did note reputational effects as one part of a plausible predatory pricing scheme. *Id.* at 936 n.5.

[6] Leslie, *supra* note 5, at 312.

[7] *Matsushita*, 475 U.S. at 592.

[8] *In re* Baby Food Antitrust Litig., 166 F.3d 112 (3d Cir. 1999).

[9] Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993). Leslie's criticism follows Kenneth L. Glazer, *Predatory Pricing and Beyond: Life After* Brooke Group, 62 Antitrust L.J. 605 (1994).

[10] Leslie, *supra* note 5, at 321 (quoting *Brooke Group*, 509 U.S. at 235).

with the record, which showed that demand for cigarettes fell continuously. The majority's reasoning, Leslie argues, displayed ignorance of both post-Chicago economics and the history of the tobacco industry, as well as a bad case of confirmation bias.

Leslie also criticizes recent court of appeals decisions granting summary judgment in pricing-fixing cases. In *Williamson Oil*,[11] for example, the court displayed both hindsight bias and ignorance of cartel behavior in rejecting the allegation (and supporting evidence) that Philip Morris had restored a cartel by a drastic price cut in the mid-1990s. Similarly, the court in *Citric Acid*[12] displayed confirmation bias and ignorance of cartel behavior in rejecting evidence of communications that suggested that Cargill was a participant in the citric acid cartel. He offers interesting reevaluations of the evidence in other recent cases.[13]

Leslie objects that the Court in *Matsushita* erred by relying on shaky empirical and theoretical assumptions to craft a procedural rule—the standard for summary judgment—that has become a substantive rule of almost per se legality. He does not object in principle to the evaluation of plausibility in the context of summary judgment, only to its misapplication as a vehicle for orthodox Chicago School theory. He suggests that the "answer lies in educating judges about how businesses operate when they are trying to monopolize or cartelize a market."[14] He proposes seminars, patterned on those organized by conservative organizations in the past, to expose judges to post-Chicago theories and modern studies of cartel dynamics.

He also proposes reinterpreting *Matsushita* to require a heightened, but not insurmountable, standard for summary judgment when the court determines that alleged conduct is apparently implausible. He suggests courts should require more evidence to avoid summary judgment, but should give greater weight than they do presently to certain categories of probative evidence. These categories include direct testimony about price communications and to "plus factors," defined (in its older sense) as structural and behavioral features of the market that make collusion more likely. While these changes may mean more cases go to juries, Leslie suggests the shortcomings of jury decision making are manageable and preferable to inappropriate "judicial application of economic theory."[15] He concludes that "[a]ntitrust doctrine would be well served if judges focused less on theory and more on the facts before them."[16]

Many readers will find reason to question Leslie's argument at various points. I would suggest, for example, that courts' resistance to post-Chicago theories of anticompetitive effect, particularly in the area of predatory pricing, has less to do with lack of awareness (the theories, after all, have been out there for a while) than with ideology and related empirical (and largely untestable) assumptions about the relative competence of courts and markets in promoting the consumer interest.[17] I also would suggest that the difficulties he identifies in the cartel cases stem in large

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11 Williamson Oil Co. v. Philip Morris USA, 346 F.3d 1287 (11th Cir. 2003).

12 *In re* Citric Acid Litig., 191 F.3d 1090 (9th Cir. 1999).

13 He discusses *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan*, 203 F.3d 1028 (8th Cir. 2000) (en banc); *Adaptive Power Solutions, LLC v. Hughes Missile Systems Co.*, 141 F.3d 947, 949 (9th Cir. 1998); and *In re DDAVP Direct Purchaser Antitrust Litig.*, No. 05-2237, 2006 U.S. Dist. LEXIS 96201 (S.D.N.Y. Nov. 2, 2006).

14 Leslie, *supra* note 5, at 343.

15 *Id.* at 352.

16 *Id.* at 353.

17 *See, e.g.*, William H. Page, *The Ideological Origins and Evolution of U.S. Antitrust Law*, *in* 1 ABA Section of Antitrust Law, Issues in Competition Law and Policy 1 (Wayne Dale Collins ed., 2008); William H. Page & John E. Lopatka, *Economic Authority and the Limits of Expertise in Antitrust Cases*, 90 Cornell L. Rev. 617 (2005).

part from the inadequacy of the law's definition of agreement in the Sherman Act context.[18] Nevertheless, the article offers an interesting application of post-Chicago and behavioral economics to important areas of antitrust law. ●

—WHP

[18] *See, e.g.*, William H. Page, *Facilitating Practices and Concerted Action Under Section 1 of the Sherman Act*, *in* ANTITRUST LAW AND ECONOMICS (Keith Hylton ed., forthcoming 2010); William H. Page, Twombly *and Communication: The Emerging Definition of Agreement Under the New Pleading Standards*, 5 J. COMPETITION L. & ECON. 439 (2009); William H. Page, *The Gary Dinners and the Meaning of Concerted Action*, 62 SMU L. REV. 597 (2009).