Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *We review three papers in this edition—two that could be categorized as background reading for the proposed Merger Guidelines revision; and a third that could sound the death knell for plaintiffs in rule of reason cases. The first paper, by Baye and Wright, asks empirically whether the complexity of the antitrust matter and the extent to which judges have grounding in economic analysis affect the likelihood that a trial decision will be appealed; the second, by Sidak and Teece, argues that the Guidelines should better reflect the realities of dynamic, Schumpeterian competition; and the third, by Carrier, examines and classifies the rationales for decision of all of the cases in which courts expressly applied the rule of reason over the past decade. Send suggestions for papers to review, or your comments, to: page@law.ufl.edu or jwoodbury@crai.com.*

—*William H. Page and John R. Woodbury*

Recent Papers

Michael R. Baye and Joshua Wright, Is Antitrust Too Complicated for Generalist Judges? The Impact of Economic Complexity & Judicial Training on Appeals (Aug. 21, 2009)
http://www.abanet.org/antitrust/at-source/09/10/Oct09-BayeWright10-23.pdf

Against the backdrop of the FTC and DOJ's announcement that they will consider revisions to the Merger Guidelines, there are two papers that could be categorized as "background reading" for the revision. One of the papers, by Michael R. Baye (former chief economist at the FTC and now at the University of Indiana) and Joshua Wright (George Mason University School of Law), addresses the extent to which the economic complexity of antitrust cases, joined with the "generalist" training of lower court judges, has affected the likelihood of appeal of lower court decisions.

The paper begins by noting that antitrust has moved away from what were in effect per se market share-based rules to identify market or monopoly power to an effects-based analysis. But the effects-based analysis is inherently more complex than calculating market shares, and so the economics have become more "daunting for a generalist judge grappling with questions involving merger simulations, demand elasticity, critical loss analysis, the competitive effects of horizontal mergers or vertical restraints, and evaluating conflicting econometric analyses." The paper also notes that "modern critiques of important antitrust decisions frequently amount to a claim that the judge misunderstood or misapplied the relevant economics, failed to recognize the critical economic issue, or relied on the opinions and analysis of the wrong expert."

This paper puts that view to the test by asking empirically whether the complexity of the antitrust matter and the extent to which judges have grounding in economic analysis affect the likelihood that a trial decision will be appealed. The paper focuses on the likelihood of appeal because "the appeal rate is a signal generated by actual costs incurred by the parties who, informed by their economic experts, are in a good position to evaluate whether the initial court committed . . . 'reversible error.'" The paper subsequently notes that economically complex cases

"are likely to result in larger zones of reasonable factual disagreement on substantive issues and divergent expectations with respect to the likelihood of success on appeal." The authors acknowledge that while there may be other grounds for appeal, they nonetheless conclude that "a lower appeal rate likely means that the judge issued fewer opinions that left at least one party feeling strongly enough to invest in the opportunity to persuade an appellate court that the initial court committed reversible error."[1]

Problem 1: *Statements in the paper like the last cited above tend to conflate training with complexity. That is, the appeal rate is not, in and of itself, an indicator of the lack or strength of the economic training of the judge or of the complexity of the case. The paper addresses two separate questions, which aren't always clearly distinguished in the text. To wit, is a judge more grounded in the economics of antitrust less likely to render an appealable decision than less well-trained judges, holding constant the complexity of the case? Is a more complex antitrust case likely to result in a greater appeal rate, holding constant the training of the judge? In complex cases like* Microsoft*,* Trinko*, or* Whole Foods*, highly credentialed economists (and lawyers) disagreed ex post with the initial and appealed decisions even of well-trained judges. Thus, it is reasonable to expect that more complex cases are more likely to generate appeals because there will be "larger zones of reasonable factual disagreement on substantive issues." In short, one would expect higher appeal rates for more complex cases even when the judges have a solid grounding in economics. The only remaining question, then, is whether the economics training reduces the likelihood of appeal in more complex matters.*

The authors use a standard econometric technique ("Probit") to relate the probability that a decision will be appealed to an array of different factors including the economic complexity of the case, the economic "training" of the judges, the extent to which the judges had prior experience on antitrust cases, identity of the plaintiff, the type of case, and the location of the case, among others.

Bottom line: economically complex antitrust cases are 10 percent more likely to be appealed than "simple" antitrust cases (after controlling for other factors); some grounding in economics significantly reduces the likelihood of appeal in simple cases by 10 percent compared to no training, but has no effect on the appeal rate in complex cases; and repeated exposure to antitrust cases has no effect on the likelihood of appeal. Thus, these results suggest that for complicated cases, training the bench is not an answer, nor is a more specialized court that focuses on antitrust (given the apparent lack of learning-by-doing).

Assessing the credibility of these results requires understanding the data used to reach these conclusions. The authors collected a sample of 714 FTC and district court cases over the period 1996–2006.[2] The relevant case characteristics included whether or not the decision was appealed, the kind of case (merger, monopolization, price fixing, Robinson-Patman, and multiple claims), and the plaintiff (DOJ, FTC, private party, state AG). All of this seems reasonable.[3]

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1 To the extent that the variables measuring the economic complexity of the case and the training of the judges in particular are uncorrelated with these other non-substantive (e.g., procedural) reasons for filing an appeal, then the analysis of the authors won't be biased even if other factors are not included.

2 There are seventy-three FTC decisions rendered by administrative law judges included in the sample, and nearly 95 percent of them were appealed to the Commission. Given the structure of the FTC—where the Commission itself is the final decision maker, this is probably not surprising. However, there was no noticeable difference in the reported results if these decisions are excluded from the sample.

3 The sample here is not a random sample of antitrust cases, but rather (as the authors note) a sample of "close call" cases. It's possible that the results for the "typical" antitrust case might differ from the close-call sample, but characterizing decisions in cases generally as economically sound or not would require both a substantial amount of effort and a slew of subjective judgments.

To identify the economic complexity of the case, the authors electronically searched the decisions to identify the presence (or not) of fourteen key terms "that one would expect to arise in a complex antitrust case involving sophisticated economic or econometric evidence." These keywords included (among others) econometrics, economist, statistical evidence, regression, expert witness, expert report, and economic report. The paper defines a case as complex if the decision contains at least one of these fourteen terms. About 500 of the sample cases—nearly 70 percent of the total sample—were "simple" in that they contained none of these keywords.

Problem 2: *While identifying the characteristics of a complex case is complicated, the paper's definition of complexity may be too simplistic. Some "complex" cases will be much more complicated than others and so one would expect the degree of complexity to affect the likelihood of an appeal. One could imagine, for example, identifying cases in which both parties had retained one economist and other cases where multiple economists were retained by one or both parties, signaling more complex cases. However, that admittedly would have required more than just an electronic search of the decisions. Perhaps in future work, the authors might consider a complexity measure that is somewhat less crude. But even with key word identification, the paper could have defined complexity continuously as (for example) the number of times these keywords in the aggregate appeared in the decisions.*

Problem 3: *As noted above, the paper focuses on the likelihood of appeal because "the appeal rate is a signal generated by actual costs incurred by the parties who, informed by their economic experts, are in a good position to evaluate whether the initial court committed . . . 'reversible error.'" But for "simple" cases, this rationale is not likely relevant. These are cases where the decision failed to mention any of the key words, including economist, Professor of Economics, expert witness, economic expert, or expert report. It seems reasonable to infer that no economist was part of the proceeding, and so the reasons for appeal in the simple cases had to be motivated by something other than an investment in the economic analysis.*

As discussed, a key focus of the paper is on the extent to which economic training of judges renders antitrust decisions sufficiently more clear cut so that appeals are less likely (at least based on the economic complexity of the case). Economic training is measured as whether the judges participated in a workshop sponsored by the George Mason University Law and Economics Center. As noted above, that training apparently was related to a lower appeal rate for simple cases, but had no statistically significant impact for complex matters.

Problem 4: *This definition of the "economic training" variable is obviously quite narrow, its key advantage being (apparently) that with relative ease, the authors could track which of the judges attended the workshop. At best, one would hope that this variable is highly correlated with the "true" economic training of the judges, including undergraduate and graduate-level courses, law school antitrust and economics courses, and other workshops (including, for example, various ABA workshops). It's not obvious why such a correlation would be present. In one variant of its analysis, the paper does include a variable indicating whether the judge has any graduate degrees, and that variable had a statistically insignificant impact on the appeal rate.*

How much weight one places on the results of this paper—that complex cases are significantly more likely to be appealed than simple cases, that the training of judges affects the appeal rate in simple but not complex cases, and that prior antitrust case experience does not affect the appeal rate—depends on the confidence one has in the measures of these variables in the paper. Given how these variables were constructed, the results could be spurious. Still, it is surprising that complexity and training had any effect on the appeal rate. And it's particularly troubling that prior antitrust experience did not affect the likelihood of appeal, holding complexity constant. If

these results were to withstand further empirical scrutiny, searching for greater simplicity in antitrust analysis (perhaps through revisions to the Guidelines), might be worth the candle.

J. Gregory Sidak and David Teece, Rewriting the Horizontal Merger Guidelines in the Name of Dynamic Competition

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1403930

Speaking of Merger Guideline revisions, Gregory Sidak (Criterion Economics) and David Teece (University of California–Berkeley) have drafted a short to-do list for the "Gang of Six" from the FTC and DOJ tasked with revising the Guidelines as an apparent prelude to a longer paper. First, the paper makes the argument that the Guidelines should better reflect the realities of dynamic, Schumpeterian competition, lamenting that the current Guidelines are far too static. A set of Guidelines that accounts for dynamic competition would, for example, substantially eliminate the relevance of market definition and market share.

Second, the authors disagree with Judge Posner and the Antitrust Modernization Committee (among others) that dynamic competition can be addressed within the current Guidelines. They contend that an effort to squeeze the square peg of dynamic competition into the round hole of the Guidelines' static framework will result in an incoherent policy towards dynamic competition. Indeed, they observe that in a somewhat contradictory fashion, the AMC itself recommended the Guidelines be revised to account for dynamic efficiencies.

The paper argues that incorporating dynamic competition explicitly into the Guidelines is all the more pressing because the Guidelines have become embedded in the legal framework for antitrust analysis, including Section 1 and 2 cases: They are concerned that changes to the Guidelines to better reflect dynamic competition will take considerable time to be accepted by the courts and "it is unlikely that a coherent merger policy that recognizes the role of dynamic competition will emerge if the Antitrust Division and FTC fail to exercise leadership."

In making this pitch for a revision to the Merger Guidelines, Sidak and Teece introduce the notion of dynamic competition in, well, Schumpeterian terms: Dynamic competition focuses on competition for the market via innovation, rather than competition in the market. But the paper fails to tell us what this means for merger policy—even if the competition is for the market, under what circumstances is a merger between firms competing for the market anticompetitive? It would certainly not be surprising to find that such Guidelines would focus on the same kinds of factors currently used in merger analysis: are the two rivals close competitors, are there other equally close competitors, what are the obstacles to entry and repositioning, what are the efficiencies from the merger?

As judged by their numerous references to the *Microsoft* litigation, Sidak and Teece are clearly playing off of the dynamic efficiency arguments used to explain Microsoft's adoption of exclusionary practices. Thus, the paper notes that we should be prepared to tolerate a small deadweight (allocative) loss from monopoly if the gains are new products that are preferred by consumers. (Of course, this is not the right calculation—the Guidelines are largely focused on consumer welfare, not total welfare, and so the loss in consumer welfare from anticompetitive practices can be substantially larger than the deadweight loss.)

But even if portions of the Guidelines (e.g., the market definition discussion) are used in the context of Section 1 and 2 cases, the Guidelines are first and foremost about mergers, not about single-firm conduct. And to the extent that the dynamic competition arguments used in *Microsoft* were viewed as cover for exclusionary practices, then there is likely to be considerable skepticism

about the validity of this defense to what would otherwise be an anticompetitive merger. In short, making dynamic competition the central paradigm in the revised Guidelines does not seem very likely. And given what many may view as the typically nebulous nature of these dynamic claims, that outcome may be justified.

This short paper also makes other pitches for Guidelines revisions largely unrelated to tailoring the Guidelines to a dynamically competitive market environment. One is the suggestion that the remedies under the Guidelines should match the two-year horizon considered in merger cases, or the more reasonable suggestion that at least the "agencies should address the issue of developing an appropriate time horizon" for remedies. The authors also suggest that the revised Guidelines address developments in the understanding of two-sided markets (e.g., where firms provide platforms used to match different consumer sets).[4]

In addition, the paper believes that in revising the Guidelines, the agencies should consider the implications of "subtler counterfactuals"—namely, absent a merger, the relevant counterfactual may be "that prices that would otherwise fall might be stabilized" or that quality-adjusted post-merger prices may increase even if nominal prices fall. And a revised set of Guidelines might be more pro-active in identifying alternative merger transactions that would "have a lesser risk of reducing competition."

Accounting both for mergers that reduce quality and for the extent to which prices would otherwise have fallen would require no more than footnotes to the existing Guidelines—these are factors that now are typically addressed in the course of merger investigations. The call for the agencies to identify more competitively acceptable merger partners is such a large giant step in the direction of industrial engineering that such a call is unlikely to be embraced by the agencies, for the usual panoply of reasons why the government should not second-guess decisions of private investors.

The paper closes by raising the specter that increased sector-specific regulation by the government, as the authors believe is likely to be the case during the Obama administration, could lead to "considerable amounts of bad antitrust analysis." The paper, in particular, cites the FCC's review of the XM-Sirius merger as an example of bad antitrust analysis. For that reason, Sidak and Teece believe that if dynamic competition is to have a role in this sector specific analysis, the agencies need to be aggressive in asserting leadership in antitrust enforcement so as to guide the debate.

My suggestion: Wait till the more detailed version of this paper is drafted.

—JRW

Michael A. Carrier, The Rule of Reason: An Empirical Update for the 21st Century
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1480440

In this short paper, Professor Michael Carrier of Rutgers-Camden School of Law clarifies the practical meaning of the rule of reason. He calls his approach empirical because he examines and classifies the rationales for decision of all of the cases in which courts expressly applied the rule of reason over the past decade. But this sort of study is also squarely within the legal realist tradition, because it shows that what courts actually do is at least as important as what they say.[5] His

[4] For example, a game system can be considered a platform that matches one set of users (game developers) with another (game players).

[5] I adopted a similar approach in William H. Page, *The Limits of State Indirect Purchaser Suits: Class Certification in the Shadow of* Illinois Brick, 67 ANTITRUST L.J. 1 (1999).

results are especially interesting because of the growing prevalence of the rule of reason in antitrust law generally.

The paper updates a similar study Carrier published in 1999 that reviewed 495 cases decided under the rule of reason since 1977.[6] He concluded in that article that courts applying the rule of reason use a burden-shifting approach. They first require the plaintiff to "show a significant anticompetitive effect."[7] If the plaintiff does so, the burden shifts to the defendant to "demonstrate a legitimate procompetitive justification."[8] If the defendant carries that burden, the plaintiff is given an opportunity to show that "the restraint is not reasonably necessary or that the defendant's objectives could be achieved by less restrictive alternatives." Only if the case passes that gauntlet does the court balance the anticompetitive and procompetitive effects. In 1999, Carrier found that 84 percent of the cases ended in a judgment for the defendant at the first stage of this analysis because the plaintiffs failed to show that the defendant's conduct was anticompetitive. Only 3 percent of the cases were decided in favor of the plaintiff when the defendant failed to carry its burden of offering a procompetitive justification. In another 1 percent of cases, the plaintiff successfully rebutted the defendant's justification and in 4 percent, the court actually engaged in balancing.

For the new paper, Carrier identifies 222 cases in which courts disposed of an antitrust case under the rule of reason.[9] The burden-shifting pattern he found in the 1999 article was equally visible in this new data set.[10] Carrier usefully categorizes the formulations of the test in the various circuits, but concludes that the burden-shifting pattern is almost universally followed, with possible exception of the Eleventh Circuit, which appears to allocate to the plaintiff the burden of proving both anticompetitive effect and the absence of a procompetitive justification.

The results of the study are striking. In the last decade, the courts disposed of an overwhelming 215 of 222 cases on the grounds that the plaintiff failed to show defendant's conduct was anticompetitive, either because the conduct itself was not objectionable (110 cases) or because there was no market power (66 cases) or both (32 cases). In none did the defendant lose for failing to offer a justification and in only one did the defendant win by offering an unrebutted justification. In only five did the court engage in balancing,[11] with defendants winning all but one. The bottom line is that defendants lost only one reported rule of reason case.

The one plaintiffs' victory was in *United States v. Visa U.S.A. Inc.*,[12] in which the court held that Visa's rule prohibiting member banks from issuing rival credit cards reduced output and price competition, and was not justified by the goal of fostering network cohesion. In the other balancing cases, including the Ninth Circuit's decision[13] after remand of the *California Dental Association*

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[6] Michael A. Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 BYU L. Rev. 1265.

[7] *Id.* at 1268.

[8] *Id.*

[9] Carrier conducted a Westlaw search using the terms "DA(aft 2/2/1999) & antitrust & (rule +2 reason)," which resulted in 738 hits. Of these, 222 resulted in a dispositive decision. He ignores nondispositive rulings like denials of summary judgment or dismissal on the pleadings, or grants or denials of preliminary injunctions.

[10] *See also* Thomas A. Lambert, Dr. Miles *Is Dead. Now What?: Structuring a Rule of Reason for Evaluating Minimum Resale Price Maintenance*, 50 Wm. & Mary L. Rev. 1937, 1997 (2009) (proposing a burden-shift approach to the rule of reason for RPM).

[11] He recognizes that there may be unreported cases in which juries balance competitive effects.

[12] 344 F.3d 229 (2d Cir. 2003).

[13] Cal. Dental Ass'n v. FTC, 224 F.3d 942 (9th Cir. 2000).

case,[14] the defendants won, even when the plaintiff made a colorable showing of anticompetitive effects, by offering a more convincing procompetitive justification for its conduct.

These results call to mind Richard Posner's observation over thirty years ago that "in practice" the rule of reason "is little more than a euphemism for nonliability."[15] That observation may not be far off for modern analysis of vertical restraints. For horizontal restraints, the observation would be inaccurate, or at least would be an overstatement of these results, because Carrier did not include in this sample cases applying quick-look analysis, which is a species of the rule of reason.[16] More generally, it could be that courts, for better or worse, are essentially deciding these cases at the characterization stage by assigning the losers to the full or fuller rule of reason category. ●

—WHP

[14] Cal. Dental Ass'n v. FTC, 526 U.S. 756 (1999).

[15] Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. Chi. L. Rev. 1, 14 (1977).

[16] *See, e.g.*, N. Texas Speciality Physicians v. FTC., 528 F.3d 346, 362–63 (5th Cir. 2008).