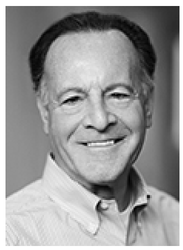
SPRING 2018

from the Section Chair

When Antitrust Met Economics

Dear Colleagues,



THIS EXCITING EDITION of ANTITRUST features pieces focusing on an array of issues at the intersection of economics and antitrust.

Economics today is central to every antitrust case. But that was not always so. From 1890 through the 1940s, economic analysis was largely an afterthought. The work of the Temporary National Economic Committee (1938–1941), which was highly critical of large firms and their impact on the economy, began to change all that. It led to governmental exposure to what economists had dubbed the structure-conduct-performance paradigm—the idea that concentrated markets lead to lessened competition which, in turn leads to poor economic performance.[1] That concept, championed in the United States by Joe Bain,[2] prompted legislative interest in strengthening merger laws.

A catalyst for that interest was the Supreme Court's 1948 decision in *Columbia Steel*,[3] which refused to hold illegal a highly unpopular acquisition by then-dominant U.S. Steel, allowing Congress to conclude that anti-merger enforcement under the Sherman Act and the original 1914 version of the Clayton Act was inadequate. The upshot was the 1950 Celler-Kefauver amendment to Section 7 of the Clayton Act, designed to halt mergers that increased concentration due to "a fear of what was considered to be a rising tide of economic concentration in the American economy."[4]

Celler-Kefauver led to *Brown Shoe*[5] in 1962 and, a year later, *Philadelphia National Bank*,[6] the Supreme Court's first serious foray into economics as a guidepost for antitrust decision-making.[7] That decision, widely reported to have been written by Justice Brennan's then-law clerk, Richard Posner, expressly endorsed the use of economics to create a presumption of illegality for mergers resulting in "undue" concentration—found there because the combined market shares exceeded 30 percent.

A few years later, active structuralism reached its zenith in the *Neal Report*.[8] It recommended blocking most mergers in markets with four-firm concentration levels above 50 percent and breaking up oligopolies (defined as markets with four-firm concentration of 70 percent or more) such that no firm would have a market share exceeding 12 percent. Even Areeda and Turner, in the first edition of their treatise, recommended "no fault monopoly" proceedings—to break up monopolies through divestitures in equitable proceedings by the government.[9]

A change in this approach began gradually, but then accelerated rapidly. The SCP paradigm came under attack from a number of lawyers and economists associated with the Chicago School,[10] and their work gave rise to the highly influential Airlie House Conference in 1974.[11] At the same time, the Department of Justice suffered its first loss in an anti-merger case under Celler-Kefauver in *General Dynamics*.[12] That development was followed in 1977 by the Supreme Court's full embrace of economic analysis in *Sylvania*,[13] and later by the highly influential 1982 Merger Guidelines.[14] Over the next several years, many of the Supreme Court's pre-economic decisions were formally (and informally) overruled.[15] As a result, today, vertical intrabrand restraints are virtually lawful per se, monopolization cases are confined to seriously exclusionary conduct, and mergers are allowed absent a high probability of increased prices or other types of tangible consumer harm.

These developments fostered concerns in the 1980s among the pro-enforcement community that reliance on economics was hampering antitrust enforcement. Fredrick Rowe expressed these views most clearly in his superb article about the "Faustian pact" between antitrust law and economics.[16] The concerns were magnified by the steep drop in merger enforcement in the 1986 to 1988 period. But what we have observed over the last few decades is quite different. Economics has provided a grounding for different antitrust theories of harm by ensuring they are theoretically sound. And it has provided new tools for antitrust enforcers, many of which are quite expansive. These theories and tools have allowed antitrust enforcers to reexamine competitive behaviors and to better understand their competitive implications. The upshot is that economics has not limited antitrust enforcement, but has provided a clear, principled framework under which the antitrust agencies are able to pursue investigations and cases—and to hone in on those cases that are most likely to be harmful to antitrust's true constituency: U.S. consumers.

Consider, for instance, how far we have come with regard to market definition. From the limitations of the quasi-economic but difficult to maneuver "practical indicia" approach to identifying antitrust-relevant markets in *Brown Shoe Co. v. United States*, we have at our disposal now sophisticated economic tools to help us stake out the appropriate market boundaries. As the agencies' 2010 Horizontal Merger Guidelines acknowledge, tests like the hypothetical monopolist/small but significant and non-transitory increase in price (SSNIP) test provide deeper insights regarding available substitutes and demand elasticities than qualitative observations alone.

Moreover, economic tools have helped agencies to better understand and identify markets where anticompetitive price discrimination may result.[17] Despite initial fears that the 1982 Guidelines' SSNIP test would lead to very large markets, permitting very large mergers and limiting the ability to bring monopolization cases,[18] almost the opposite has been true. The SSNIP test, and its price discrimination (or "targeted customers") variant, have in fact identified comparatively small markets and allowed aggressive merger enforcement when the facts allow.[19] Statistics from the Department of Justice and Federal Trade Commission's annual reports demonstrate the agencies are actively pursuing cases today—on average, bringing about 15 to 25 enforcement actions each per year.[20]

Economics has also allowed us to focus more directly on actual effects, recognizing that market definition is "not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects."[21] Scholarly work developing and testing economic tools have allowed us to assess probable competitive effects more effectively than was previously possible.

Economics has also permitted us to reevaluate more accurately other competitive actions previously presumed to be harmful. Take resale price maintenance (RPM), for example. Early cases, like *Dr. Miles Medical Co. v. John D. Parks & Sons Co.*,[22] concluded RPM was necessarily unlawful because it removed merchants' (or other distributors') discretion to set prices. Because this eliminated some amount of (intrabrand) price competition, courts perceived RPM as going to the heart of what antitrust laws were intended to prevent.

Considering the underlying economics, however, led the courts to more enlightened conclusions. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[23] the Court relied heavily upon economic theory and insights. It explained that while RPM may increase some prices, the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance," including—importantly—aligning incentives between manufacturers and retailers and avoiding free riding.[24] The Court further acknowledged that these procompetitive justifications often spur competition between brands in ways that benefit consumers, by encouraging brands to improve showrooms, invest in product demonstrations, train employees, and preserve brands' reputations. Because fostering these many benefits is a goal of antitrust, the court refused to find such arrangements per se unlawful. That is, the Court adopted an economically grounded approach that utilized theory and empirical evidence to establish a framework that better preserves the consumer welfare benefits at the heart of antitrust law.

These and numerous other decisions and agency actions reflects the many benefits of closely integrating economics into antitrust analysis and case law. The close kinship between antitrust and economics that has enhanced our understanding and enforcement of competition laws continues to this day. The articles in this issue reflect this ongoing relationship. They tackle some of the most interesting and challenging issues for antitrust law today—including how mergers impact innovation, the treatment of network effects, and the benefits of new and existing economic tools—providing both interesting and practical insights into the state of modern antitrust law. ■

All the very best,

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1 Edward Chamberlin, Theory of Monopolistic Competition (1933); Edward S. Mason, Economic Concentration & the Monopoly Problem (1964).

2 Joseph S. Bain, Barriers to New Competition (1956).

3 United States v. Columbia Steel Co., 334 U.S. 495 (1948). *See also* Fed. Trade Comm'n, The Present Trend of Corporate Mergers and Acquisitions, 80th Cong., 1st Sess. (1947).

4 Brown Shoe Co. v. United States, 370 U.S. 294, 315–16 (1962).

5 *Id.*

6 United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963).

7 *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377 (1956), was something of an exception, relying on cross-elasticity of demand (in ways later criticized) as the guidepost for market definition.

8 Phil C. Neal Et Al., Report of the White House Task Force on Antitrust Policy 2 *reprinted in* 2 Antitrust L. & Econ. Rev. 11 (1968–1969) [hereinafter *Neal Report*]. Robert Bork dissented. Interestingly, William Baxter did not.

9 Phillip Areeda & Donald Turner, Antitrust Law ¶¶ 630–638 (1st ed. 1978).

10 The seminal piece was Robert H. Bork & Ward S. Bowman, Jr., *The Crisis in Antitrust*, 1965 Colum. L. Rev. 363.

11 The papers are collected in Industrial Concentration: The New Learning (Harvey Goldschmid et al. eds., 1974).

12 United States v. Gen. Dynamics Corp., 415 U.S. 486 (1974).

13 Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

14 U.S. Dep't of Justice, Merger Guidelines (1982).

15 These are collected in Jonathan Jacobson, Scholarship & Antitrust (2016), https://www.wsgr.com/publications/PDFSearch/jacobson-0116.pdf.

16 *See, e.g.*, Frederick M. Rowe, *The Decline of Antitrust and the Delusion of Models: The Faustian Pact of Law and Economics*, 72 Geo. L.J. 1511 (1984).

17 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines §§ 3–4 (2010).

18 Gordon B. Spivack, *New Merger Guidelines Are Substantially Different*, Legal Times, Aug. 2, 1982, at 38.

19 *E.g.*, FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015) (broadline foodservice distribution to national customers); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 58–60 (D.D.C. 2011) (do-it-yourself tax preparation products).

20 See Fed. Trade Comm'n, Competition Enforcement Database, https://www.ftc.gov/competition-enforcement-database (last visited Jan. 18, 2017); U.S. Dep't of Justice & Fed. Trade Comm'n, Hart-Scott-Rodino Annual Report, Fiscal Year 2016, https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014_fy_2016_hsr_report_final_october_2017.pdf.

21 Horizontal Merger Guidelines, *supra* note 17, § 4.

22 220 U.S. 373 (1911).

23 551 U.S. 877, 895–96 (2007).

24 *Id.* at 889.