Antitrust Law

Economic Theory and Common Law Evolution

This book is an effort to consolidate several different perspectives on antitrust law. First, Professor Hylton presents a detailed description of the law as it has developed through numerous judicial opinions. Second, the author presents detailed economic critiques of the judicial opinions, drawing heavily on the literature in law and economics journals. Third, Professor Hylton integrates a jurisprudential perspective into the analysis that looks at antitrust as a vibrant field of common law. This last perspective leads the author to address issues of stability and predictability in antitrust law and to examine the pressures shaping its evolution. The combination of these three perspectives offers something new to every student of antitrust law. Specific topics covered include perfect competition versus monopoly, enforcement, cartels, Section 1 doctrine, rule of reason analysis, boycotts, market power, vertical restraints, tying, exclusive dealing, and horizontal mergers.

Keith N. Hylton has taught at the School of Law of Boston University since 1995. He previously served on the faculty at Northwestern University School of Law. Professor Hylton currently teaches courses in antitrust, torts, and labor law, and he writes widely in the field of law and economics, with more than forty publications in American law journals and peer-reviewed law and economics journals. Professor Hylton has also served as a director of the American Law and Economics Association.

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To my parents and the memory of my brother Kenneth

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Preface

This book is, at least in part, the result of frustration. As a teacher of antitrust law, I found that the available textbooks did not offer the range of perspectives I try to give my students. I hope this frustration is reflected here. It has led me to push hard to create something that does not fit into one of the molds offered by the existing textbooks.

The available textbooks on antitrust approach the subject from one of two angles, law or economics. From the law angle, one finds either law casebooks or hornbooks. The law casebook, for those who have never seen one, is a compilation of excerpts from important court opinions, interspersed with discussions and questions contributed by the casebook authors. As a way of learning the important results of a court decision, the casebook is inefficient. One is forced to read through lengthy court opinions in the end to note one or perhaps as many as three important legal propositions. In addition, I have often found myself thinking, as I looked at a casebook, that the author is trying to push me in a certain direction without stating his opinions openly. I prefer to see opinions set out openly.

The format of this book avoids what I see as the drawbacks of the casebook. The case summaries state concisely the important legal propositions, and clearly separate them from the less important statements. Following each case, I discuss whether the decision can be defended on economic or legal grounds. My aim is not to brainwash students; it is to push them to question all aspects of the decision, from legal validity – that is, consistency with prior decisions and relevant statutory law – to policy considerations.

The other style of law textbook is the hornbook, in which the author summarizes the cases and provides some synthesis of the law. The benefit

of this approach is that it avoids the inefficiency of the casebook – forcing the student to read four hundred pages in order to extract forty legal propositions. The key drawback of the hornbook is that it can die quickly. The law and our understanding of it change over time. The legal propositions associated with a decision that we think are important today may not be tomorrow, while the less important statements may gain in prominence. The casebook, by setting out the decision in full, is capable of changing as views of the law change. The standard hornbook does not have this adaptability.

I hope that the format of this book avoids the early death problem. Bork's *Antitrust Paradox* did not die early because it presents a sustained theoretically consistent critique of antitrust doctrine. Theory plays an important role in making any discussion of the law worthy of reading after the law has changed. Theory provides a method of understanding or explaining the law, and an objective standard for criticizing it. These standards exist independently of the statement of the law. The reader of a theoretical hornbook such as Bork's picks up more than just the case law, and this is what makes the theoretical hornbook adaptable and capable of withstanding shifts in legal doctrine. I hope I have immunized this book in the same way.

What does this book contribute to the many textbooks already out there? First, I have tried to integrate law and economics at a reasonably high level. Some of the discussions of economic issues are pitched at the advanced-undergraduate economics level. The issues are simply too deep to try to cover as many and remain at a level that assumes absolutely no training whatsoever in economics. Thus, one important difference between this book and most antitrust textbooks, especially law texts, is that I devote a great deal of energy to discussing the relevant economics.

Of course, if one had the time, one could get all of this material out of some of the better antitrust casebooks. The footnotes of the recent Areeda editions (coauthored with Louis Kaplow) contain references to much of the relevant theoretical work in economics. But no one has the time to consult all of the references. I have tried to incorporate some of the recent teachings in a simple way, sparing the reader the task of hunting down journal articles. The reader who seeks a deeper treatment of the issues can read the articles cited in the footnotes of this text, or consult an advanced textbook such as Jean Tirole's *The Theory of Industrial Organization*, and from there embark on a broader search of the literature.

The other side of the coin in this integration process is the law. Unlike most textbooks that stress the economics of antitrust, I have presented the law in a detailed way. I summarize and provide economic analyses of the major and minor legal propositions of each decision. In some instances, I draw attention to minor parts of opinions that have interesting economic implications.

Second, this book attempts to present the material as simply and straightforwardly as possible. I have tried to avoid highfalutin economic and legal terminology. I have tried to explain economic concepts in simple terms with simple examples. As a result, even though the book deals with some advanced issues, the presentation should be easy to follow even if the reader has not had much training in either law or economics.

Third, unlike either the law textbook or the economics textbook, this book attempts to integrate discussion of some issues in common law theory. By common law theory, I mean the exploration of such issues as certainty of law, the relative merits of rules versus legal standards, the process of legal evolution, and the capacity of courts to apply reasonableness standards to business practices. These issues are general, appearing in many fields of law outside of antitrust. I have taken a position on many of these issues, and, of course, the reader is free to disagree. For the reader who disagrees, the useful part of the discussion will be the examples in which case law and economics are integrated in a discussion of legal theory. The case law provides a set of concrete examples that illustrate some long-standing controversies in common law theory. The discussion of economics provides some content to the notion of reasonableness when used as an alternative to that of positive legal validity.

For the student of legal evolution, the most general and frequently recurring problem in antitrust law is the tension between the economic conception of a reasonableness inquiry and the administrative concerns of courts and enforcement agencies. An economically defensible reasonableness inquiry would seek to determine whether a practice, challenged as a restraint of trade, generates economic benefits in excess of its social costs. A practice that enhances society's wealth would be permitted under this standard. However, such a standard, in the antitrust realm, would tend to put courts and enforcement agencies in a disadvantaged position relative to defendants. Courts and enforcement agencies often do not have enough information to rigorously assess the economic reasonableness of a challenged practice. Such an assessment

often requires information privately held by the defendant and his business associates.

Courts and enforcement agencies have responded to this imbalance by interpreting antitrust statutes in a manner that excuses the plaintiff in certain instances from having to demonstrate that the challenged practice is economically unreasonable. The Supreme Court started along this path in its first opinion interpreting Section 1 of the Sherman Act, *U.S. v. Trans-Missouri Freight Assn*;[1] and post–Sherman Act antitrust statutes have avoided any reference to reasonableness. The problem this has generated is that courts find it very hard to move away from reasonableness standards. Indeed, to do so is to abandon the most basic feature of common law adjudication: the equation of legal validity with some notion of reasonableness. The common law process has traditionally developed, generated new law, by extending settled propositions. The extension is justified by appealing to reasonableness, whether based on cost-benefit balancing or a survey of the parties' expectations. In other words, it has not been the practice of courts in the western world to say, "this is the law, and to hell with its justification." Because the common law process requires justification of legal standards, antitrust courts are continually pushed in the direction of providing an economic reasonableness justification for every decision.

The tension between economic reasonableness and administrative concerns seems to be the principal, or at least one of the principal, driving forces in the evolution of antitrust law as a field of federal common law. In several chapters of this book, I note that the law has moved from a reasonableness inquiry to a per-se standard and then back toward a reasonableness inquiry.[2] The forces pushing in either direction are continually acting on antitrust doctrine. Indeed, it is possible to state a very simple model of antitrust evolution. Public enforcement agencies and federal statutes put pressure on courts to adopt per-se standards. This pressure pushes the law in the direction of per-se rules until, in some cases, a "validity crisis" is reached – a point at which the court can no longer defend its decisions by appealing to economic reasonableness arguments. At that point, the court either retreats from the per-se standard (*Sylvania*, Chapter 13) or reinterprets the reasonableness argu-

[1] 166 U.S. 290 (1897).
[2] See Chapters 5 (Section 1), 9 (boycotts), 13 (vertical restraints), and 15 (horizontal mergers).

ments (*Addyston Pipe*, Chapter 5). As I point out in the text, this process is observed in several areas of antitrust law.

The tension between economic reasonableness and administrative concerns also has implications for the role of economic theory in antitrust analysis. Economic theory is obviously helpful, and probably necessary, in getting a sense of the meaning of economic reasonableness; and I do not believe there is any area of economic analysis that is too abstract to be useful in this enterprise. However, there may be limits on the extent to which antitrust doctrine should reflect or take into account all of the concerns of the economic theorist. As Judge (now Justice) Breyer put it in his *Barry Wright* opinion,

> while technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists' . . . views. For, unlike economics, law is an administrative system, the effects of which depend upon the content of the rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.[3]

In view of this, the critic of antitrust doctrine must give some thought to the likelihood and cost of judicial error. Where the expected cost of error (the likelihood multiplied by the cost) is high, antitrust doctrine should stop short of requiring a full blown inquiry into all of the matters of concern to the economist. The controversial part, of course, is identifying those areas in which the expected cost of error is high enough to warrant this approach.

If the costs of error were the same, whether an erroneous finding of innocence (false acquittal) or an erroneous finding of guilt (false conviction), then we might be led by administrative concerns to adopt rules of per-se legality and per-se illegality with equal frequency. However, economic analysis permits us to state presumptions or hypotheses regarding the relative costs of false acquittals and convictions in antitrust litigation. If, with respect to a certain type of claim (e.g., predatory pricing), economic reasoning leads us to hypothesize that the expected costs of false convictions are greater than those of false acquittals, we should prefer to adopt per-se legality rules to govern these claims, and conversely. This is the primary sense in which I think economic theory

[3] *Barry Wright v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983).

should inform antitrust doctrine, and I have tried in several parts of this book to use economic reasoning in this manner.

The mixture of perspectives may make this book unsuitable for any particular class. The criticism of court decisions may seem too harsh to make appropriate material for law students. I leave these questions to the reader. At the least, I hope that this will provide answers to, or a better method of answering, many questions not covered in the standard presentations of antitrust law.

As with any project that takes a lot of time, this one benefited from the input of many people. Mark Grady, whose office was across the hall from mine in my early teaching years at Northwestern, influenced my thinking on antitrust as well as other areas of legal scholarship. Readers who are familiar with Mark's work will notice that influence in some parts of this book. Indeed, this book follows Mark's course outline, which he gave me in my first year of teaching to help me get started. I also must thank Frank Fisher, who took the time to give me detailed, page-by-page comments on a very early draft. And there are friends and colleagues, like Roger Blair, who gave me useful advice on a chapter here or there, and I am sorry that I cannot list all of them here. Finally, I should thank my former students and research assistants, especially Deborah Loesel, Brian Kaiser, and Jessica Selb, who helped with the research and inspired me to see this project through.