



Review of How the Chicago School Overshot the Mark

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Review of *How the Chicago School Overshot the Mark*

By William Kolasky*

During his successful presidential campaign, Barack Obama repeatedly described our current financial crisis as “the final verdict on a failed philosophy” of government, “a philosophy that views even the most common-sense regulation as unwise and unnecessary.”¹ While these remarks were not directed at antitrust in particular, they could well have been. As Robert Pitofsky’s timely new book *How the Chicago School Overshot the Mark* shows, during the eight years of the Bush Administration both the federal enforcement agencies and the federal courts applied this same laissez faire philosophy to the enforcement of our antitrust laws. The result was a historically low level of enforcement activity. In one essay, Carl Shapiro and Jonathan Baker document that merger enforcement activity at both agencies in 2005-2006 fell below even the previous historic lows seen during the second Reagan administration. The mergers cleared by the two agencies included one merger to monopoly in satellite radio (XM/Sirius) and a merger of the last two major domestic washer/dryer manufacturers (Whirlpool/Maytag), with a combined market share of over 70 percent, following which the merged company increased prices in the face of declining demand. Even more remarkably, after having brought three major monopolization cases in the last three years of the Clinton administration (*Microsoft*, *American Airlines*, and *Dentsply*), the Justice Department did not bring a single monopolization case during the eight years George Bush was in office.

As federal antitrust enforcement activity declined, the federal courts showed increasing hostility to efforts by private plaintiffs to fill the gap. It has been more than 15 years since an antitrust plaintiff last won a case in the Supreme Court,

*William Kolasky is a partner in WilmerHale’s Regulatory and Government Affairs Department, and a member of the Antitrust and Competition Practice Group. This article reviews *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* (Robert Pitofsky, ed. 2008).

as defendants have racked up a 16-0 record. The record is more mixed in the intermediate courts of appeals, but with conservative Republican appointees dominating 11 of the 13 circuits, the number of pro-plaintiff decisions in the lower courts is now declining as well.

A senior official in the Bush Antitrust Division has defended these judicial decisions as signaling “not less antitrust, but better antitrust.”² How the Chicago School Overshot the Mark seeks to debate this proposition. The contributors to the book, which include some of the nation’s most distinguished antitrust scholars, argue forcefully that while many of the Supreme Court’s decisions over the last 30 years were a necessary midcourse correction from the overly interventionist antitrust jurisprudence of the Supreme Court during Earl Warren’s tenure as Chief Justice, the federal antitrust agencies and the courts have now “overshot the mark” in adopting too laissez-faire an approach to antitrust enforcement. More importantly, they seek to offer specific proposals for reinvigorating antitrust enforcement, something Barack Obama has promised that his administration will do.³ With his new administration having just taken office in January, this book could not be more timely.

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The first group of essays examines how we got to where we are. As the essays explain, the fundamental cause for the shift in antitrust law over the last half century is a redefinition of the objectives of antitrust. During the Warren years, the Supreme Court was quite explicit in viewing the antitrust laws as designed to protect small enterprises in order to maintain a pluralist society, even if that resulted in some loss of efficiency.⁴ The central tenet of the so-called “Chicago School” is that this populist view of antitrust was mistaken, and that the sole goal of the antitrust laws is to promote economic welfare by protecting competition, not competitors. I put “Chicago School” in quotation marks because, as the essays in this book show, this narrower view of the objectives of antitrust was advocated not just by economists and lawyers teaching at the University of Chicago, but also by Donald Turner, Philip Areeda, and Stephen Breyer, all of whom taught at the Harvard School. None of them had any connection to Chicago, other than that one of their former students, Richard Posner, became one of the most prolific and influential members of the Chicago School.

Interestingly, none of the contributors to the Pitofsky book proposes that we revert to the Warren Court’s more populist view of antitrust, using those laws to protect small inefficient firms from large, more efficient rivals. Instead, the contributors frame the debate in terms that accept the central premise of the Chicago School, but attempt to eat away at the margins. Thus, Eleanor Fox worries that we have moved too far in the direction of trying to determine whether the outcome of a particular merger or conduct will be efficient, rather than protecting the competitive process itself, which she defines in terms of

rivalry. Similarly, John Kirkwood and Robert Lande re-examine the legislative history of the Sherman Act in an effort to show that the antitrust laws are concerned with consumer welfare, not total welfare, and that the laws should therefore be enforced in a manner that outlaws mergers and conduct that will result in transferring consumer surplus to producers. There is substantial merit behind both arguments, either of which would reduce the risk of false negatives in antitrust litigation by making it easier for plaintiffs to show that conduct is “anticompetitive.”

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This is a debate that is particularly timely. Over the last several months, we have witnessed the government having to rescue company after company because they were deemed “too large to fail.” We have also seen examples of companies that have grown through mergers and whose failure to integrate the acquired businesses has contributed to serious management fail-

ures. It is by no means clear that antitrust weapons are the right tools to use in these cases, but these cases do suggest that we may need to broaden the lens of our antitrust analysis of proposed mergers beyond a myopic focus on their immediate impacts on narrow markets, as defined using the current Merger Guidelines SSNIP test. We need to focus more attention—as antitrust did in the past—on the impact of the merger on the broader “line of commerce” in which the merging firms compete.

The second half of *How the Chicago School Overshot the Mark* focuses on how we could reinvigorate antitrust enforcement in four specific areas: dominant firm conduct; exclusionary vertical restraints; vertical distribution restraints; and mergers. These essays are in many ways of greater immediate relevance as a new administration comes into office with a commitment to reinvigorating antitrust enforcement. Together, they provide an excellent roadmap toward achieving that objective.

The first two essays, by Herb Hovenkamp and Harvey Goldschmidt, address the thorny issue of how the antitrust laws should be used to regulate dominant firm conduct. This is a topic that has recently been the subject of loud debate in Washington. In September, the Justice Department released a report entitled *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*.⁵ In that report, the Justice Department argues in favor of a narrow role for the antitrust laws in policing the conduct of dominant and near-dominant firms. The report proposes what it calls a “substantial disproportionality” test, under which the Department would not bring a Section 2 enforcement action unless a firm with monopoly or near-monopoly power engages in conduct, the anticompetitive effects of which are “substantially disproportionate” to its pro-competitive justifications. The same day, the FTC released a stinging rebuke signed by three of the four sitting commissioners, attacking the Justice Department report

as “a blueprint for radically weakened enforcement of Section 2 of the Sherman Act,” that “would place a thumb on the scales in favor of firms with monopoly or near-monopoly power” and against the interests of consumers.⁶ These conflicting views illustrate how wide the gulf is between those, like the three commissioners, who believe that dominant-firm conduct should be a major focus of antitrust enforcement, and those, like the outgoing Bush Justice Department officials, who believe that markets are inherently self-correcting and that single-firm conduct, even by dominant firms, will rarely, if ever, cause durable harm to competition.

Professor Hovenkamp’s essay was written before the Justice Department released its report, but it is clear that his views fall somewhere between the Justice Department report and the three commissioners. Rather than supporting anything akin to the Department’s “substantial disproportionality” test, or its more radical cousin, the “no economic sense” test, Professor Hovenkamp argues in favor of using a more neutral test that defines monopolistic conduct as acts that: “(1) are reasonably capable of creating, enlarging, or prolonging monopoly power by impairing the opportunities of rivals; and (2) that either (2a) do not benefit consumers at all, or (2b) are unnecessary for the particular consumer benefits that the acts produce, or (2c) produce harms disproportionate to the benefits.” The Justice Department report basically adopts this same analytical framework, but modifies the last part of the test (2c) to require that the harms be “substantially disproportionate” to the benefits in order to reduce the risk of false positives.

As I have written elsewhere, I think that the analytical framework proposed by Professor Hovenkamp asks exactly the right questions, but overlooks an important element in terms of how the test should be applied in practice in order to reduce the risk of both false positives and false negatives.⁷ As the Supreme Court recognized in *California Dental Ass’n v. FTC*,⁸ in the context of Section 1 of the Sherman Act, the rule of reason requires a stepwise analysis, in which the courts should apply a sliding scale at each step of the analysis. Thus, the stronger the showing of harm to competition in step (1), the closer the court should scrutinize the claimed benefits and the availability of less restrictive alternatives to achieve them. Applying this sliding scale, it should rarely be necessary for a court to reach the final, most difficult step of having to balance the competitive harms and benefits of the conduct at issue.

This sliding scale approach is similar to the approach the courts use in enforcing both the First Amendment and the Equal Protection Clause, scrutinizing in various degrees the proffered governmental justifications depending on the seriousness of the alleged infringement. There is no reason the same sliding scale could not be used to enforce Section 2, as well as Section 1. Doing so would avoid the need for the type of ad-hoc balancing the Justice Department seems to fear, while still allowing a much wider ambit for strong antitrust enforcement against monopolistic single-firm conduct than the “no economic sense” or “substantial disproportionality” tests would.

The next two essays, by Steven Salop and Stephen Calkins, address exclusionary vertical conduct, including tying and exclusive dealing. Both essays make a persuasive case in showing that the Chicago School critique of tying and exclusive dealing has been read too broadly and that there are, indeed, circumstances in which both types of arrangements can harm competition. Professors Salop and Calkins agree, however, that the Chicago School was right in arguing that neither form of conduct should be *per se* unlawful, and that both should be evaluated under the rule of reason. Their essays provide useful suggestions for the agencies and private plaintiffs as to how to present a convincing rule of reason case against these types of exclusionary vertical agreements.

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The penultimate two essays, by Warren Grimes and Marina Lao, deal with vertical distribution arrangements. In them, Professors Grimes and Lao recognize, as Professors Salop and Calkins do, that vertical restraints should generally be evaluated under the rule of reason, rather than condemned as *per se* unlawful. But they correctly caution against the too-easy acceptance of facile free-rider arguments, which would make vertical distribution restraints, including resale price maintenance, virtually *per se* legal. Like Professors Salop and Calkins, Professors Grimes and Lao attempt to identify the conditions in which both price and non-price vertical restraints may harm interbrand competition; proposing a set of presumptions that could be used to make the rule of reason an effective tool against such restraints. Their proposals seem generally sound, and, if followed, should serve to make the rule of reason a more effective enforcement tool against anti-competitive vertical restraints.

The final two essays, by Jonathan Baker and Carl Shapiro, focus on merger policy. As noted at the beginning of this review, they do a superb job of documenting what is wrong with merger policy today, but they do an equally effective job of proposing ways in which merger enforcement could be strengthened. Following in the footsteps of Derek Bok's path-breaking 1963 article in the *Harvard Law Review*, "Section 7 of the Clayton Act: The Merger of Law and Economics,"¹⁰ they correctly observe that because merger challenges necessarily have to predict what is likely to happen in the future, effective merger enforcement requires a set of rebuttable presumptions the government can rely on to block a merger, with the parties then having the burden of showing that their merger will not, in fact, lessen competition. Baker and Shapiro do not, however, propose to return to the purely structural presumptions of the 1960s. They suggest, instead, a set of other factors the agencies and courts should examine before presuming that a merger is likely to facilitate either a unilateral or coordinated price increase. The more nuanced presumptions they propose appear sensible as

a matter of economics, while still being reasonably administrable, and they plainly deserve serious consideration by the next administration.

In summary, Robert Pitofsky has rendered a real service by publishing this slender volume of essays at this moment in time. His contributors, all of whom have spent long careers studying the antitrust laws, plainly deserve to be listened to. My one regret is that he did not reach out more to the next generation of antitrust scholars, who will have to play the central role in reinvigorating antitrust enforcement in the way that these authors, most of whom are now nearing retirement, recognize needs to be done. ▼

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- 1 Statement by Barack Obama, "Blamed for Obama: 'Failed Philosophy' Blamed for Financial Meltdown," as reported by Susan G. for the Daily Kros, available at <http://www.dailykros.com/storyonly/2008/9/15/11025/7807>.
 - 2 See David L. Meyer, *We Should Not Let the Ongoing Rationalization of Antitrust Lead to the Marginalization of Antitrust* (Oct. 31, 2007), available at <http://www.usdoj.gov/atr/public/speeches/227399.htm>.
 - 3 Barack Obama, U.S. Senator (D-Ill.), Statement for the American Antitrust Institute (Sept. 27, 2007), available at http://www.antitrustinstitute.org/archives/files/aa-i-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf.
 - 4 *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 344 (1962) ("But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.").
 - 5 U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (Sept. 2008), available at <http://www.usdoj.gov/atr/public/reports/236681.htm>.
 - 6 See Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt>.
 - 7 William Kolasky, *Reinvigorating Antitrust Enforcement in the United States: A Proposal*, ANTITRUST, Spring 2008, at 85, 87-89.
 - 8 526 U.S. 756 (1999).
 - 9 Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).