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The Error Cost Approach to Section 2 Legal Standards

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The "error cost" or "decision theory" approach to Section 2 legal standards emphasizes the probabilities and costs of errors in monopolization decisions. Two types of error, and two associated types of cost are examined. One type of error is that of a false acquittal, or false negative. The other type of error is that of a false conviction, or false positive. Under the error cost approach, a legal standard should be chosen that minimizes the total expected costs of errors.

Suppose, for example, the legal decision maker has a choice between two legal standards, A and B. Suppose under standard A, the probability of a false acquittal is 1/4 and the probability of a false conviction is 1/5. Under standard B, the probability of false acquittal is 1/5 and the probability of a false conviction is 1/4. Suppose the cost of a false acquittal is $1 and the cost of a false conviction is $2. The expected error cost of standard A is therefore .25 + (.2)($2) = $.65. The expected error cost of standard B is .2 + (.25)($2) = $.70. Since the expected error cost of standard B is greater than that of standard A, standard A should be preferred.

In monopolization law there are several legal standards that have been applied by courts and proposed by commentators, such as the balancing test, the specific intent test, the profit sacrifice test, the disproportionality test, the equally efficient competitor test, no-economic-sense test, and others. Almost all of the tests can be grouped under the alternative categories of balancing or non-balancing tests. Under the error cost approach, the ideal legal standard for any given area of monopolization law is the one that generates the smallest expected error cost. Moreover, each of these tests has been proposed as a default rule to be applied across the board, but which can be abandoned in a specific case that merits an alternative standard.

The Department of Justice's 2008 Section 2 Report reviews the various monopolization standards and embraces the disproportionality test as the best default rule. The disproportionality test holds the defendant liable under Section 2 only when the anticompetitive effects of his conduct are disproportionate in light of the precompetitive benefits. This is an approach that makes sense if one adopts the view, as did the authors of the Section 2 report, that the costs of false convictions under monopolization law are larger than the costs of false acquittals. The disproportionality

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test is quite close in application to the specific intent test, the no-economic-sense test, and one version of the profit sacrifice test.

Although it is ultimately an empirical question, there are several reasons to adopt the presumption that false conviction costs are greater than false acquittal costs in the monopolization context. Two of the most persuasive reasons are based on the incentives for entry and for rent-seeking. The costs of false acquittals in the monopolization setting can be kept in check through the threat of competitive entry. The costs of false convictions, on the other hand, generate rent-seeking incentives to file suit under Section 2 on the part of firms that compete against dominant firms. Another important reason for the presumption is the asymmetric impact of errors. False acquittals permit one firm, the falsely-acquitted defendant, to continue practices that harm consumers. False convictions overdeter dominant firms in general, and can lead to a form of soft competition which is especially harmful to consumers.

One of the key purposes of error cost analysis is to serve as bridge between economic theory and legal standards in antitrust. Economic models often assume courts can implement legal tests with perfect accuracy. But this is not always true. The accuracy of a balancing test that requires courts to distinguish vigorous competition from predation will depend on the quality of judges, juries, lawyers, and the procedural mechanisms in place for conducting a trial. Even a small risk of error leading to a possible multibillion dollar trebled judgment can lead a firm that has not engaged in anticompetitive conduct to alter its conduct to avoid the risk of an antitrust lawsuit. For economic theory to lead to useful recommendations for antitrust courts, analysts must consider the likelihood of error and the costs of error under proposed monopolization tests. Error cost analysis provides a framework for courts to screen and assign "value weights" to the recommendations from economic analysis.

The decision of the new DOJ Antitrust Division to abandon the 2008 Section 2 Report is, in part, a signal that it intends to adopt different enforcement priorities, and, in part, a signal that its ambition is to challenge existing Section 2 law. If the latter, then it is also an effort to reverse or set aside the adopted lessons of the error cost approach. This is a tall order, given the slow pace of change of legal doctrine, and especially the theories that undergird them. The Antitrust Division is unlikely to be successful in this more ambitious effort.

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