Paper Trail: Working Papers and Recent Scholarship

Editors' Note: *In this edition, we offer two notes. The first critically examines two new papers, both published in the Fall 2003 issue of the* Journal of Economic Perspectives*, that assess the welfare effects of antitrust enforcement. The second note is an extended summary by Paper Trail Editor Bill Page of a paper that he co-authored with John Lopatka. The paper examines the role of judicially-endorsed economic theory in the control of economic expert testimony in antitrust.*

Send your comments and suggestions for papers and other works to review to: page@law.ufl.edu or jwoodbury@crai.com.

—WHP & JRW

Papers and Summaries

Robert W. Crandall & Clifford Winston, Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence, *J. Econ. Perspec.*, Fall 2003, at 3; and Jonathan B. Baker, The Case for Antitrust Enforcement, *J.Econ. Persp.*, Fall 2003, at 27.

These two papers consider the question of whether the "game" of antitrust enforcement has been worth the candle. The Crandall-Winston paper concludes that given the antitrust enforcement track record, the antitrust agencies "would be well advised to prosecute only the most egregious anti-competitive violations." In sharp contrast, Baker concludes that given his reading of the evidence, "retreating to a minimalist antitrust policy makes no sense. Instead the goal should be to apply sensibly . . . the tools of antitrust enforcement."

At best, this is a highly skewed point/counterpoint exchange. The Crandall-Winston paper takes the Baker paper on in only one isolated footnote. Baker (who, by way of full disclosure, is also a senior consultant with my employer, CRA), by contrast, peppers his review with a significant number of "counterpoints." Nonetheless, both papers offer highly readable perspectives on antitrust enforcement. On the strength of the analysis and evidence offered, in this rumble, the belt must go to Baker.

For example, Crandall and Winston use six important monopolization cases brought by the Federal Government—*Standard Oil*, *American Tobacco*, *Alcoa*, *Paramount*, *United Shoe*, and *AT&T*—to illustrate the ineffectiveness of or the harm created by antitrust enforcement. In evaluating *United Shoe*, the paper supposes that if the decree succeeded in reducing machinery prices, it is "highly likely" that shoe manufacturers would have incurred lower machinery expenses as a result. Crandall and Winston conclude that there was no price effect because the value of shoe machinery shipments to the value of shoe shipments was stable between 1954 and 1967. While the paper acknowledges that a combination of lower machinery prices plus a substitution of machines for labor could have generated the same outcome, "no evidence exists to support this conjecture." Does that mean that the authors sought to find such evidence? Or are they just offering a conjecture on a conjecture? If so, then the evidence can't distinguish between two competing hypotheses—that the consent decree did or did not have the effect of reducing prices.

With respect to *AT&T*, the authors conclude that the only reason for any pro-consumer divestiture effect was the fact that prior to bringing the 1974 case, the FCC was the chief obstacle to increased long distance competition. This is no doubt true, but not quite the complete story. There are many who have observed that in mid-1970s through 1981, the vertically-integrated AT&T fought at every turn the

FCC's efforts to compel AT&T's provision of equal access by long-distance rivals to the local exchange network. The resulting divestiture of AT&T—and the subsequent and rapid increase in long-distance competition—highlighted the inherent weaknesses of conduct regulation and the pro-consumer role antitrust can play (*Trinko* notwithstanding), even where the remedies are radically structural. In important dimensions, the equal access that followed the divestiture confirmed the predictions of those economists (and lawyers, such as William Baxter) that such access would be difficult if not impossible to attain as long as the regulated AT&T remained integrated into local and long-distance service.

As another example, the Crandall-Winston paper conducts an empirical study of the effects of merger enforcement on the price-cost margins in two-digit SIC industries. The authors conclude that at worst, antitrust enforcement has been generally ineffective and may actually have harmed consumers. But this is the kind of highly aggregated study (are the broad two-digit SIC industries really antitrust markets?) with questionable implications that in part sparked Chicago's successful "new learning" movement in the 1970s, which continues to shape antitrust thought (see *Trinko*, for example). (The Baker paper points out other apparent shortcomings of this approach.)

Most of these points (and others) are made in the Baker paper. As noted above, both papers are well worth the read. One can hope that Crandall and Winston will, in a sequel, address the Baker counter-arguments more completely.

—JRW

John E. Lopatka & William H. Page, Economic Authority and the Limits of Expertise in Antitrust Cases, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=507542

In this lengthy paper, John Lopatka and I argue that *economic authority*—a body of economic knowledge that appellate courts adopt from the scholarly literature—defines and controls the role of economic expert testimony in antitrust litigation. We offer both positive and normative analyses of the relationship between the two sources of economic knowledge. The following Note is a bit longer than the usual Paper Trail summary because of the length of the paper.

I. Introduction

Recent studies have suggested that interdisciplinary legal scholarship is not influencing courts in most areas of law. For example, few states' courts have adopted explicitly economic theories of common law torts. Empirical surveys have found that the number of citations of law review articles by courts has plunged by almost one-half in the last twenty years—roughly the period in which interdisciplinary scholarship has gained ascendancy. In the same period, however, the federal courts have transformed antitrust law, relying extensively on economically informed legal scholarship. The doctrinal changes have not necessarily taken the form antitrust scholars have proposed, because courts have their own views of the institutional constraints they face. Nevertheless, the scholarly literature has played a major role in the erosion or elimination of rules of per se illegality, the emergence of doctrines of antitrust injury and standing, and in the creation of new standards of sufficiency of evidence. We call the economic ideas that the courts adopt from the scholarly literature "economic authority"—a body of theoretical models and empirical generalizations that courts use to guide the application of the substantive law.

One effect of these changes has been to expand the role of economic expert testimony in antitrust cases. The move to the rule of reason, for example, has required experts to define relevant markets in more cases. And the adoption of explicitly economic tests for practices like

predatory pricing has required experts to gather and analyze data necessary to prove the requisite facts. Nevertheless, bright-line rules still embody economic choices that limit the range of expert opinion that is admissible. At the same time, the courts have maintained and in some instances increased their controls on expert testimony. The *Daubert* trilogy (*Daubert*, *Joiner*, and *Kumho Tire*) has brought the *Daubert* motion to antitrust litigation; now experts must show that their methodologies meet criteria of reliability. Courts also continue to evaluate the substance of expert testimony in the context of motions for summary judgment and for judgment as a matter of law. We argue that economic authority guides all of these inquiries: it defines the role of experts, directly limiting the subjects on which they can testify and the models and methodologies they can use. The paradox of this arrangement is that economic ideas courts have adopted as legislative fact in the common law process without any test of reliability (other than that they appear in the scholarly literature) can trump and constrain economic ideas of experts that must meet criteria of scientific reliability.

II. Models and Fact-Finding

The legal system nominally assigns issues of fact to the jury and issues of law to the court, but this familiar distinction is a gross oversimplification. Juries decide normative issues in applying legal criteria (e.g., "reasonableness"), and those decisions influence the law. Courts, especially in common law areas like antitrust, can also narrow or expand the domain of fact by changing substantive rules and standards of sufficiency. Definition of the domain of fact depends in part on courts' assessments of the jury's competence to resolve issues using their common knowledge and common sense.

Expert testimony plays a unique role in this process, because it depends on models and analyses that are far from jurors' common experience. Jurors are asked to choose between experts whose testimony is in direct conflict. This process may be untrustworthy for many reasons: the testimony may go over the jurors' heads; the witness may be a plausible charlatan; and even a qualified witness may slant testimony to favor his employer's positions. Courts recognize these potential shortcomings, and thus have created a gauntlet of constraints through which expert testimony must pass before a jury can consider it: the expert must be qualified; and the testimony must be relevant to an issue in the case, within the expert's expertise, based on a reliable methodology, and legally sufficient to raise a jury issue.

III. Economic Models and Antitrust Decision Making

Economic expert testimony in antitrust litigation is formally subject to the same controls as other kinds of expertise in other legal contexts. But the application of those controls in antitrust is different because it is guided by economic authority, which courts adopt by judicial notice as legislative fact. Antitrust has always relied on economics, but in the past thirty years it has begun to rely explicitly on the scholarly literature in formulating and applying antitrust rules. The Supreme Court has, for example, adopted Chicago models of resale price maintenance, predatory pricing, tying, and cartels, along with related empirical generalizations. The Court has not, however, relied on the models to adopt rules of per se legality, as some Chicagoans have proposed; instead, it has replaced rules of per se illegality with the rule of reason; narrowed the remaining rules of per se illegality through the characterization inquiry; imposed requirements of antitrust injury and standing; and increased the standards for sufficiency of evidence. These choices affect expert testimony. Expert testimony has become more important with the waning of rules of per se illegality. Nevertheless, the chosen rules and underlying economic models frame and constrain that

testimony. Courts use economic authority to police experts' qualifications, and their testimony's relevance, reliability, and sufficiency.

IV. Judicial Control of Expertise

We examine the role of judicial controls on expertise in the contexts of predatory pricing; market definition and market power; the characterization and proof of horizontal agreements; and damages.

Predatory Pricing. The Court has formulated criteria for predatory pricing that sharply confine expert testimony. In *Matsushita*, expert testimony was insufficient to create a jury issue because the Court found it implausible in light of Chicago School models of predation. In *Brooke Group*, the Court made clear that above-cost pricing is never predatory, thus foreclosing any testimony by economists willing to testify to the contrary. The court of appeals in *American Airlines* recently read *Brooke Group* to require a showing of pricing below some measure of incremental cost—thus rendering insufficient expert testimony applying various measures that included fixed costs.

Market Definition and Market Power. Issues of market definition, as Judge Posner has noted, now involve mainly "questions of fact within a settled framework of economic theory," i.e., economic authority. Courts directly examine experts' proposed market definitions using this framework. In the recent *Menasha* case, for example, Judge Easterbrook rejected as "economically irrelevant" experts' testimony that "at-shelf coupon dispensers" constituted a separate market, noting that the experts had failed to examine whether the price or quantity of the product varied with those of other promotional services. Market power in antitrust, by contrast, is a term of art that means something different from economic market power. The law's focus on market share and concentration levels as proxies for market power, for example, set important limits on the substance of expert testimony.

The market definition and market power issues in the context of aftermarkets (markets of a durable goods manufacturer for parts and service for its own products) provide an interesting case study of the battle of economic authority in the Supreme Court and the consequences of victory for a theory. In *Image Technical*, Kodak's Chicago-inspired argument was that it could not have market power in its aftermarkets if it did not have market power in the equipment market because any attempt to gouge its equipment customers would have hurt sales in the equipment market. Justice Scalia agreed. But the plaintiffs' brief touted the scholarship of Steve Salop that suggested that information and switching costs might allow exploitation of consumers; the brief added gravitas by announcing that Professor Salop had helped write it. The Court was evidently impressed, citing three of Prof. Salop's articles in the opinion. Those ideas provided the framework for expert testimony on remand.

Cartels: Characterization and Proof of Agreement. The per se illegality of price fixing forecloses expert testimony that naked price fixing is innocuous. But proof of price fixing still may require expertise in characterizing the practice and proving an agreement. Characterization requires the court to evaluate the likely competitive effect of a practice based on the practice's "facial" characteristics—essentially those that are undisputed—in order to determine the degree of "empirical" scrutiny that the practice requires. Thus, the court conducts a kind of preliminary rule-of-reason analysis to determine whether the alleged practice warrants scrutiny under the per se rule, the rule of reason, or something in between. This process may seem paradoxical, but something like it occurs whenever courts apply formal, bright-line rules: the court must go back to the policies underlying the rule to determine whether the rule applies in a particular case.

One example of the role of economic authority in the characterization process is *California Dental Association*, in which the FTC challenged the CDA's restrictions on price and quality adver-

tising. Nominally, the CDA's rule prohibited misleading advertising, but in practice, the association prohibited many forms of discount advertising and any advertising of quality. The FTC offered no expert witnesses in the administrative trial, relying instead on the scholarly literature to show the anticompetitive effects of restrictions on professional advertising. The court of appeals initially held the practices unlawful under a quick look rule of reason analysis, but the Supreme Court, citing the literature on the "lemon effect," found the CDA's arguments in support of its advertising restrictions sufficiently plausible to justify a more searching inquiry. On remand, the court of appeals found that the higher level of scrutiny required the FTC to produce more specific evidence of anticompetitive effect in the California dental market. In effect, the economic authority offered by the FTC was insufficient, in light of the economic authority of the lemon effect, to shift the burden of proof to the CDA.

If there is no direct evidence of an agreement, expert testimony will typically be required to marshal the circumstantial evidence necessary to infer one. "Agreement" in antitrust is another term of art, albeit one informed by the indeterminate economics of oligopoly pricing. The law of collusion contains safeguards designed to prevent juries from too-easily finding rational oligopolists guilty of price fixing. Thus, many courts will not permit an economist to testify to the ultimate issue of whether the evidence justifies an inference of "agreement." If the economist is using the term correctly, the issue is outside of his expertise; if she's using some other definition of agreement, her testimony is irrelevant. Nevertheless, experts can testify to the existence of practices and conditions that might facilitate coordination and to whether those practices make sense for a firm acting independently to adopt. This evidence is subject to widely shared standards of reliability in the selection and analysis of data.

Damages. Probably the most common use of experts in antitrust cases is to prove damages. But economic authority frames this role as well. First, the requirements of antitrust injury and standing define which of the harms that antitrust offenses inflict are compensable. An expert may not testify that the plaintiff has suffered lost profits, if, as in *Brunswick*, the plaintiff lost profits because the alleged practice merely preserved competitors in the market. An expert (in federal court) also may not testify that the plaintiff has paid an overcharge, if, as in *Illinois Brick*, an intermediate purchaser passed on the overcharge to the plaintiff. In both of these cases, the Supreme Court relied on the economics of the practices at issue to shape the domain of factual issues on which experts would be permitted to testify.

Second, the standards of proof allow the court to determine whether the plaintiff has actually suffered the alleged antitrust injury. Here again, economic authority guides the evaluation of the proof. The expert typically gathers data concerning a normative period, then uses statistical methods to project what the experience of the plaintiff would have been, absent the unlawful conduct. The difference between the actual experience in the damage period and the but-for experience is the measure of damages. This process requires a theoretical evaluation of the practice to identify the relevant factors to include in a regression model used to estimate the effects of the violation. Courts police this process by requiring the expert to use an appropriate theoretical model of the alleged practice, to gather reliable data, and to include the appropriate variables in the damage model.

V. Implications

The courts gather economic knowledge from the scholarly literature and use it in the formulation and application of antitrust rules, including those governing expertise. The process by which they acquire this knowledge is subject to none of the requirements of scientific reliability that the court

has imposed on the reception of expert testimony at trial. Nevertheless, it defines the areas in which expertise can be offered, in some instances foreclosing any consideration of economic opinions that are entirely respectable. And in those areas in which it permits or requires expertise, courts rely on their own reading of economic authority to evaluate expert testimony for reliability, relevance, and helpfulness.

Problematic as this may sound, we suggest that economic authority must have primacy if antitrust law is to evolve. Nevertheless, courts should make the process as transparent as possible by identifying the literature on which they are relying, and their own theoretical reasoning. And they should be alert to the possibility that the economic literature may itself be created for litigation and thus be potentially suspect on the same grounds as "hired gun" expert testimony. In determining the role of expertise, courts should take account, first, of the robustness of the economic theories on which they rely and, second, of the institutional context in which litigation occurs.

These factors clarify the roles of Chicago and Post-Chicago economics (PCE) in antitrust. Chicago theories, as we have seen, have had an enormous effect on the evolution of antitrust. Post-Chicago theories have had some notable successes, e.g., in *Image Technical*, but have more often met with resistance. Some have suggested that they are unsuited to antitrust rulemaking because they are either indeterminate or require so many assumptions that they become intractable. Others have suggested that post-Chicago models do not meet *Daubert*'s standards of reliability. We suggest, however, that the characteristics of PCE make it suitable as both economic authority and expert testimony in particular instances. They may be used to challenge proposed rules of per se legality and may generate testable hypotheses of anticompetitive effects in particular cases, as in *Staples*. Moreover, game theoretic analyses may help explain pricing strategies in predatory pricing cases and identify independent motivations for conduct in evaluating evidence of agreement.

VI. Conclusion

Courts gather economic knowledge based on their sense of its explanatory value and of its usefulness in resolving antitrust issues, given the institutional characteristics of the legal system. Courts can use economic authority to impose rules that foreclose factual issues (embodying the knowledge ex ante), or rules that allow the ex post acquisition of the information necessary to identify competitive effects. The latter course typically involves expertise, with all its attendant dangers. Consequently, courts have also relied on economic authority to directly supervise the qualifications, methodologies, and opinions of experts. ●

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