Consumer Federation of America

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On

Is There Life After *Trinko* and *Credit Suisse?*
The Role of Antitrust in Regulated Industries

Subcommittee on Courts and Competition Policy
Committee on the Judiciary
U.S. House of Representatives

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Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research of the Consumer Federation of America. I appreciate the opportunity to appear before you today to offer the consumer view of a recent turn in antitrust jurisprudence that poses a severe threat to competition and consumers.

Judiciary Committee hearings about antitrust principles are invariably stacked with lawyers who argue about whether the principle or practice at hand is good law, especially when viewed through the lens of past antitrust practice because precedent plays a prominent place in antitrust cases. That is certainly true in the case of the *Trinko* and *Credit Suisse* rulings being discussed today, but I believe that this issue can and should be approached in a more direct fashion. The courts and congress should move swiftly to reverse this ruling because it is bad policy based on faulty economic reasoning.

These cases establish regulation as a barrier to antitrust oversight, without requiring the court to examine the effectiveness of regulation in controlling behaviors that are repugnant to both regulation and antitrust. Trinko in particular presumes antitrust has high cost and low benefits without demanding a careful accounting of the costs and benefits. It assumes false positives are plentiful, more likely and more costly than false negatives without any empirical evidence to support that claim. It is the ultimate triumph of economic theory over fact in the antitrust space. These decisions favor corporations and regulation at the expense of competition and antitrust to such an extent that, as Howard Shelanaski has shown,[1] many of the landmark cases in U.S. antitrust history would never have made it through the courts.

After a decade in which we have watched large corporation inflict huge losses on the economy and society – Worldcom, Enron, Lehman Brothers, Goldman Sachs, and BP – the notion that large corporations can be expected to behave in economically efficient and socially responsible ways because there is a convergence between their private interest and the public interest or that regulation can be presumed to be effective in protecting the public interest seems rather silly. We need every regulatory cop on the beat and antitrust is one of the most important weapons policymakers have to protect the public from anticompetitive, anti-consumer business practices. To preemptively sideline antitrust policy in the industries where is it needed most – those with the greatest market power – is a huge mistake.

The Flawed Economic Theory Underlying *Tinko/Credit Suisse*

In 2008, Robert Pitofsky, former Chairman of the Federal Trade Commission, edited a thoughtful volume on the development of antitrust practice in the past couple of decades entitled *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust.*[2] Published just before the financial meltdown, the book seems a little timid, since many leading economists, Chicago Schoolers, like Allen Greenspan, there was a flaw in the theory.

[1] Howard Shelanski, "The Case for Re-balancing Antitrust and Regulation," *SSRN*, March 18, 2010.

[2] Robert Pitofsky (Ed.), *How the Chicago School Overshot the Mark* (Oxford: Oxford University Press, 2008).

> "Those of us who looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets state of balance…
>
> "If it fails, as occurred this year, market stability is undermined…
>
> "I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms.

Buried, if not dead, beneath the rubble of the financial market collapse, lies the efficient market hypothesis, the single most important cornerstone of conservative economics. Once you admit A *Failure of Capitalism*,[3] you must re-examine all of the policies pursued in the name of a flawed economic theory. The conclusion to Pitofsky's introductory essay in the volume characterizes damage well, a characterization that fits Trinko and *Credit Suisse* cases to a tee.

> "Specific concerns include preferences for economic models over facts, the tendency to assume that the free market mechanisms will cure all market imperfections, the belief that only efficiency matters, outright mistakes in matters of doctrine, but most of all, lack of support for rigorous enforcement and willingness of enforcers to approve questionable transactions if there is even a whiff of a defense.[4]

Exhibit 1 identifies dozens of ways in which conservative economic theory led to lax antitrust enforcement that severely underestimates the harm that anticompetitive practices impose on the economy under the claims of under invest in antitrust. The Exhibit also notes the flaws in economic thinking in the conservative approach to antitrust that afflict the *Trinko and Credit Suisse* rulings. Indeed, the *Trinko* and Credit *Suisse* decisions take the errors of conservative economics to a whole new level. Left to stand, they would institutionalize a bias against antitrust analysis that is totally unjustified by a century of antitrust practice or the contemporary record of antitrust analysis. Simply put, the *Trinko/Credit Suisse* decisions indicate that under the influence of conservative economics, the Supreme Court has not simply overshot the mark; it has gone off the deep end.

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[3] From Richard Posner, *A Failure of Capitalism* (Cambridge: Harvard University Press, 2009), on the right to Joseph Stiglitz, *FreeFall* (New York, W.W. Norton, 2010), on the left, the critical weakness of market fundamentalism has been acknowledged. The efficient market hypothesis ahs come in for particular criticism (Frank Portnoy, *Infectious Greed* (New York, Henry Holt, 2003); George Cooper: *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Hypothesis* (New York: Vintage, 2008; Justin Fox, *The Myth of the Rational Market* (New York: Harper, 2009); John Cassidy, *How Markets Fail,* (New York: Farrar, Straus and Giroux, 2009).

[4] Pitofsky, p. 5.

EXHIBIT 1:
CRITIQUE OF MARKET FUNDAMENTALISM IN ANTITRUST ENFORCEMENT*
UNDERLINED FLAWS REFLECTED IN TRINKO RULING

Fundamental Flaws

Over-reliance on the market to cure everything (4, 5)
Over-emphasis on efficiency to excuse everything (5)
Over-estimation of ease of entry and expansion of output (42, 236)
Failure to recognize wealth transfers as a cause of consumer harm (90)

Faulty analytic approach

Over-reliance on economic models, that privilege theory over fact (5, 42, 57, 82)
Over-concern about false positives rather than false negatives (52, 123)
Failure to require empirical evidence leads to over-estimation of efficiency gains (18, 42)
Failure to require demonstration of mechanism for pass through of efficiency gains (263)
Defines markets too broadly, resulting in underestimation of market power (243)
Failure to recognize non-economic impacts and causes (42)
Places burden on the wrong party and imposes impossibly high standards of proof (164, 260)
Ignores subjective evidence and customer views (165, 243)

Substantive Weaknesses

Underestimation of horizontal impacts
Overbroad claims of importance of monopoly rents as inducement to competition (85)
Overbroad claims of importance of intellectual property monopoly to innovation and R&D (6, 3, 183)
Downplaying ability of leading firm to raise rival's costs and engage in predatory practices including pricing, boycott, tying, bundling, retaliation, (27, 57, 80, 126)
Non-cooperative gaming ability to raise prices (6. 56), divide markets (6)
Importance of anticompetitive impacts of network effects (56)

Failure to recognize the anticompetitive potential of vertical leverage (52, 127, 141)

Over-reliance on single monopoly profit to absolve harm of maker power (40)
Overstated defense and incomplete analysis of vertical restraints (19, 186)
Potential effects of vertical leverage by (1) creating market power in tied product, (2) maintaining market power in tying product, (3) facilitating collusion and parallelism, (4) evading regulation
Enhanced tools of monopolization through (1) raising rivals cost, (2) refusal to deal (3) increases barriers to entry

Policy outcomes that harm competition and consumers

Under appreciation of the importance of concentration allows merger to domination (6, 236)
Under enforcement and tendency to do nothing (6, 36, 37)
Failure to use structural solution (29, 122, 126)
Over-protection of autonomy of leading or dominant firms (86, 127, 165)
Under-emphasis on dynamic efficiency and competitive rivalry (79, 80)
Lack of appreciation for the role of mavericks (81)

*Pages references are to Robert Pitofsky (Ed.), *How the Chicago School Overshot the Mark* (Oxford: Oxford University Press, 2008). Earlier discussions of this critique of conservative economics can be found in: Mark Cooper, "Comments of the Consumer Federation of America on the Proposed Horizontal Merger Guidelines," *Federal Trade Commission*, FTC File No. PO92700, June 4, 2010; "The Analysis of Market Failure After the Collapse of Market Fundamentalism: The Implications of the Defeat of the Chicago School for Antitrust and Regulation in the U.S. Energy Sector," *10th Annual energy Roundtable: Major Developments in Energy Markets*, American Antitrust Institute, March 2, 2010, presents a discussion of the critique for energy markets; "Testimony of Mark Cooper, on Consumers Competition and Consolidation in the Video Broadband Market," *Commerce Committee, U.S. Senate*, March 11, 2010 pp. 7-9 presents this critique as applied to the Comcast-NBCU merger.

The *Trinko/Credit Suisse* court places regulation above antitrust, without allowing an examination of the effectiveness of the regulation, an approach that is particularly ironic since conservative economics generally takes a dim view of the ability of regulators to promote the public interest. If anything, the theory should have led the court to give antitrust a wider berth, not a narrower one.

The reason the court turned in the wrong direction is that it was influenced by a series of the most fundamental flaws in conservative economics identified in Pitofsky's volume, excessive deference to theoretical models and efficiency claims, excessive concern about false positives, protection of dominant corporations, and a failure to recognize the importance of wealth transfers.

All of these flaws were neatly summarized in the remarkable claim that "monopoly profits" are the wellspring of economic progress. To be sure, supra normal profits are the carrot, but competition is the stick. Rewards to innovation yield supranormal profits, which may be associated with gains in market share, but they should not be equated with "monopoly profits" in the sense that the term is typically used. In a dynamic economy, innovation rents are quickly should be quickly dissipated by competition. In the case at hand, if the court had bothered to look, it would have been quite clear that any supranormal profits had nothing to do with innovation and everything to do with using market power to frustrate competitive entry and raising the competitors' costs. The whiff of efficiency was provided by the theoretical possibility that there might be a drop of innovation rent or efficiency gain in an ocean of anticompetitive rent seeking.

The Importance of Balance Between Regulation and Antitrust

The simultaneous jurisdiction of antitrust and regulation was created over a century ago, during the Progressive era, when policy makers realized that the modern industrial economy was creating huge corporate enterprises that could easily amass market power that robbed the economy and the public of the benefits of competition.[5] There are industries in which market power is so pervasive that prudential regulation is necessary on an ongoing basis. Although competition is preferable, regulation is a second best, better than the unfettered exercise of market power. The decision to regulate does not cancel the preference for competition and the antitrust laws are simultaneously applied to constantly probe for areas where competition can improve the public welfare. Regulators are not particularly adept at this role because it is not their core competence and they have a tendency to be captured by the industries they regulate.

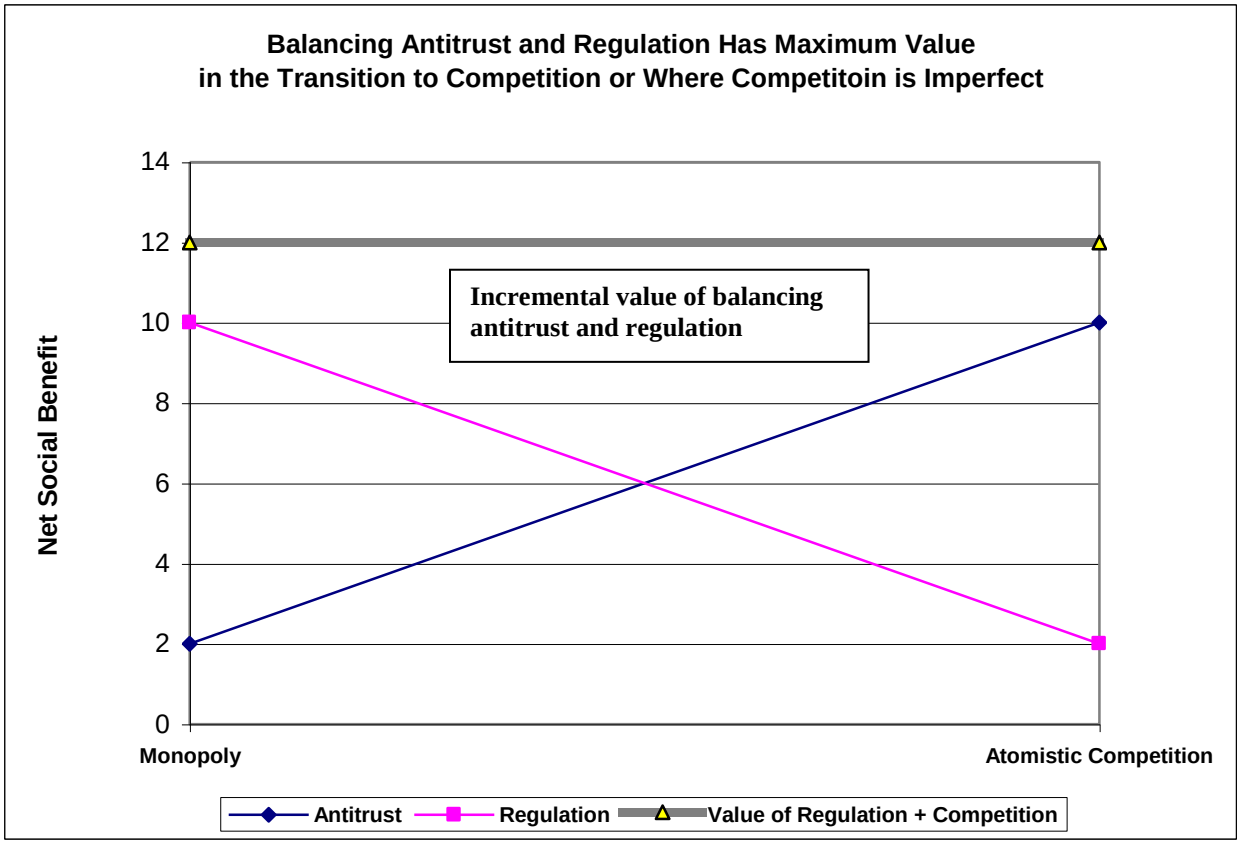
These principles were reaffirmed in the New Deal, as prudential regulation was layered atop aggressive antitrust enforcement to repair the damage that irresponsible market behavior and lax antitrust enforcement had done to the economy in the 1920s. For fifty years, vigorous enforcement of the antitrust laws combined with effective oversight of market power through regulation to produce a remarkable record of economic growth and progress. Antitrust and regulation worked hand in had to prevent the accumulation of market power, where markets should support vigorous competition, and to regulate market power where they cannot. Balance is the key to creating a dynamic, progressive capitalist economy.

[5] The Sherman Act of 1890 was passed three years after the Interstate Commerce Act or 1887.

That balance was destroyed by the *Trinko/Credit Suisse* decisions.

The balance was destroyed at a moment when, and in an area where the value of antitrust was highest. As Shelanski has argued, the greatest value of the balance between regulation and antitrust exists where the market structure is least certain – where there is a transition between regulation and competition or where there are a mix of competitive and monopoly aspects to the market. Exhibit 2 presents a graphic representation of the idea.

EXHIBIT 2:



When underlying characteristics dictate that monopoly is the efficient outcome, there will be little cost to under enforcement of antitrust, since there are few gains to be made by imposing competitive solutions. When atomistic competition is sustainable, regulation will impose inefficiencies on the industry. But these pure types of markets are few and far between. Much of a 21st century economy resides in the middle range. The telecom sector was seeking to move to a greater reliance on competition after a century of reliance on monopoly. The incumbent telephone companies were determined to prevent that progress. Under their litigious, obstinate foot dragging, the effort to open the network collapsed. The transition would have benefited

from careful antitrust scrutiny. The Trinko decision not only prevented that scrutiny in this case, but it severely restricted the likelihood of such scrutiny in the future.

Conclusion

The expression "hard cases make bad law" has risen to the status of a proverb, with a history stretching back well over a century, but this is an instance where an easy case was used as an excuse to make bad policy.[6] *Trinko* was a stretch of the antitrust laws that the court could have easily brushed aside, if it was so inclined, without changing the terrain of antitrust law. That was the easy and prudent thing to do, especially when citing the regulatory scheme of a statute that expressly stated that it was not Congress' intention to restrict the applicability of the antitrust laws. Instead, the court used a weak case to make a major change in antitrust practice applying a theory that had been increasingly discredited in recent years.

The court could take steps to remedy the situation in future cases by making it clear that the *Trinko* decision applies only to private antitrust suits and its application to private antitrust actions rests on the unique regulatory obligations and oversight embodied in the 1996 Act. Given the extremist ideology that underlies the decision, we are doubtful that the court will be inclined to fix the problem any time soon. Therefore, Congress should act swiftly to restore the balance between antitrust and regulation that worked well in the 20th century.

[6] "Hard cases make bad law, no doubt, and maybe bad policy, *Spectator* 21 July 2001, http://www.answers.com/topic/hard-cases-make-bad-law