"ANTITRUST WELFARE" – THE BRODLEY SYNTHESIS

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INTRODUCTION

"How Did Economists Get It So Wrong?"[1]

This is the title of Nobel Prize winner Paul Krugman's lead article in the *New York Times Magazine* in September 2009. The article is about macroeconomics and the financial meltdown. The question applies equally to microeconomics and the competitive meltdown, even though the dots have not yet been so graphically connected.

Professor Krugman asserts that, before 2008, economists were congratulating themselves on their success. They had, they thought, reached the "golden era for the profession";[2] they had resolved the main disputes. They failed to see the financial crisis coming because they so unquestioningly trusted markets. "[T]he economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth."[3]

Long before, Krugman says, economists had been shaken by the Great Depression; but memories of the depression faded, and "economists fell back in love with the old, idealized vision of an economy in which rational individuals interact in perfect markets, this time gussied up with fancy equations."[4] "They turned a blind eye to the limitations of human rationality," and to the limits of institutions and markets.[5] Entranced by their "all-

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[1] Paul Krugman, *How Did Economists Get It So Wrong?*, N.Y. TIMES, Sept. 6, 2009, § MM (Magazine), at 36.

[2] *Id.*

[3] *Id.* at 37.

[4] *Id.*

[5] *Id.*

encompassing, intellectually elegant approach," they were willing "to dismantle economic safeguards in the faith that markets will solve all problems."[6]

So has it been in microeconomics and its role in antitrust policy, particularly for mergers and monopolies. For most of a quarter century, antitrust enforcement against anticompetitive mergers and monopolistic practices has been barely visible, and intellectually elegant justifying equations and text have consumed many pages.

They should have listened to Joseph Brodley.

Rereading a range of Professor Brodley's antitrust scholarship spanning a third of a century, one is struck once again by his extraordinary qualities. Professor Brodley is a true scholar's scholar. His work is immensely thoughtful and careful. It assimilates the scholarship and jurisprudence that form the base of the current thinking and current law, and asks the most basic questions of perspective. Brodley calls attention to reality while colleagues admire the emperor's new clothes. He values empiricism as well as theory. He proposes practical rules and frameworks to make antitrust workable. Doing so, Professor Brodley is not ideological. He is not an enemy of the Chicago School; rather, he is grateful for its insights, and builds on many of them. But he points out matter-of-factly the limits of the limits of antitrust. In certain very specific ways, his scholarship runs decisively against the grain of the Chicago School. His work, even his early work, is remarkably durable, and holds distinct lessons for how, at this stage, to correct beauty by truth.

What points would I single out as major contributions of Joe Brodley in trying to set the right compass for antitrust? I would single out five. First, his insistence on *setting* the compass, and doing so in a way congruent with law, economics, theory, experience, and reality. Second, his privileging of innovation (dynamic efficiency) over static efficiency. Third, his articulation of the critical importance of rivalry as the tool to promote dynamic efficiency. Fourth, his insistence that we can and must incorporate strategic theory in analysis, and his demonstration how this effort can be made workable by presumptions, safe harbors, and defenses. Fifth, his stress on incentives: incentives to innovate, including innovation by firms without power, and incentives of market actors to make the antitrust law system work.

This Essay will focus on two articles by Professor Brodley in which he takes on the task of setting the compass: *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*[7] and *Post-Chicago Economics and Workable Legal Policy*;[8] it will also discuss his review of

[6] *Id.*

[7] Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020 (1987).

[8] Joseph F. Brodley, *Post-Chicago Economics and Workable Legal Policy*, 63 ANTITRUST L.J. 683 (1995).

Michael Porter's book: *The Competitive Advantage of Nations*.[9] These pieces set a framework that would have served us well in the rising years of the influence of the Chicago School, and may have counteracted the impulses that helped to produce a declining automobile industry and a non-competitive banking industry in the last years of this decade. For most of two decades, with brief respites, the country and its antitrust enforcers have been attracted more by beauty (or conviction) than truth. It is clear that recalibration is necessary.[10] The Brodley framework is a useful referent for the recalibration.

I. HOW TO UNDERSTAND THE ECONOMIC GOALS OF ANTITRUST

In 1987, Joe Brodley made a stunning observation. He observed that efficiency advocates had gained ascendancy in the debate about the goals of antitrust, "powerfully assisted by the perception that efficiency analysis in antitrust is scientific and rigorous;" but that they gained ascendancy "without any clear consensus as to what . . . ['efficiency' and 'consumer welfare'] exactly mean."[11] In the article, Brodley developed a coherent meaning. During the ascendancy of the Chicago School paradigm in the 1980s, the country was apparently not ready to adopt a coherent meaning; but the now recognized failure of the "efficiency as beauty" model may imply that the time for definition has come.

Joe Brodley's prescription is derived from the law's animating spirit, pragmatics, and economics. It is: "[T]he economic goal of antitrust policy is to increase the material welfare of society through the instrument of interfirm rivalry."[12] This is accomplished by a blending of economic efficiency and consumer welfare, pursued in a long-run time frame, concentrating on long-run structural factors such as concentration and entry and exit barriers, and driven by rivalry.[13] This unique blend of efficiency and consumer welfare achieved through the instrument of rivalry might be called, Brodley says, "antitrust welfare."[14] Antitrust welfare is not a Borkian notion of economic welfare, which views rivalry as just one instrument to reach efficiency (to be abandoned when it does not), and assumes that business acts efficiently. Rather, antitrust welfare tilts in a different direction. By the three-prong concept – efficiency,

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[9] Joseph F. Brodley, *Antitrust and Competitive Advantage in World Markets*, 5 ANTITRUST 38 (1990) (reviewing MICHAEL E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS (1990)).

[10] *See generally* HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST (Robert Pitofsky ed., 2008) [hereinafter OVERSHOT THE MARK]; Christine A. Varney, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Vigorous Antitrust Enforcement in This Challenging Era (May 11, 2009), *available at* http://www.usdoj.gov/atr/public/speeches/245711.htm.

[11] Brodley, *supra* note 7, at 1020.

[12] *Id.* at 1023.

[13] *Id.* at 1023-24.

[14] *Id.* at 1023.

consumer welfare, and rivalry – antitrust not only pursues dynamic and progressive economic goals, but it is infused with a capaciousness that also tends to serve non-economic goals of antitrust without sacrificing social welfare to protectionism; thus, it bypasses the debate about the non-economic goals of antitrust.

Having set the perspective, Brodley proceeds to canvas the types of efficiency: productive, allocative, and dynamic (innovative). He identifies dynamic efficiency as by far the most important.[15] Its benefits overwhelm both allocative efficiency and productive efficiency. Yet static efficiency has consumed the enforcement agencies.[16] The striking result, says Brodley, is that antitrust misallocates enforcement resources by directing most of its resources to practices that "injure pricing efficiency in output markets" (cartels) while ignoring exclusionary conduct that disincentivizes innovation.[17]

Brodley observes that "consumer welfare is the most abused term in modern antitrust analysis."[18] Bork uses the phrase as a synonym for efficiency. Some use it to denote an unidentified consumer interest. Some use it to suggest the moral superiority of their position. To be operational, as Brodley states, consumer welfare must be defined. He suggests that it should be defined in terms of explicit economic benefits received by consumers of a particular product measured by price and quality.[19] Brodley proposes that consumer welfare should be harmonized with the general social interest in efficiency by subordinating immediate interests of consumers to long-run efficiencies, as long as consumers will significantly share eventually in the economic welfare promised, for example, by innovation.[20]

Brodley demonstrates how his construct is a practical basis for workable antitrust. He disputes the Chicago claim that the law and the state of the economic art cannot deal with anything other than austere antitrust (efficiency is the goal and firms act efficiently). Brodley catalogs the growing body of economic literature that had (even by 1987) expanded our knowledge of strategic behavior, and sharpened our ability to distinguish conduct that is profit-making only by disadvantaging rivals from conduct that is efficient.

This perceptive article of twenty years ago sets the stage for my claim: Joe Brodley's scholarship bridges the gap between preferences for efficient

[15] *Id.* at 1026.

[16] *Id.* at 1025.

[17] *Id.* at 1031.

[18] *Id.* at 1032.

[19] *Id.* at 1033.

[20] *Id.* at 1037. The formulation bears a striking resemblance to the structure of Article 101 of the Treaty on the Functioning of the European Union and the justifications allowed under Article 101(3). Treaty on the Functioning of the European Union, art. 101(1), (3), May 9, 2008, 2008 O.J. (C 158) 47. Article 101(1) prohibits agreements that distort competition and Article 101(3) allows a justification for agreements that are on balance procompetitive or technologically progressive and include no indispensable restraints. *Id.*

outcomes[21] and preferences for rivalry as the guidepost for antitrust, and moves us closer to the new paradigm that we need post-post-Chicago.

II. ANTITRUST, RIVALRY, AND COMPETITIVE ADVANTAGE

When Michael Porter's now famous book, *The Competitive Advantage of Nations*,[22] appeared a few years later, it gave Joe Brodley a platform to reinforce his own work and intuitions. Michael Porter prescribed rivalry, rivalry, and rivalry.[23] He prescribed *close* rivalry.[24] Competition from Japan and Germany is good – it is very good – but there is nothing like competition in your own backyard. Joe wrote a book review of *The Competitive Advantage of Nations* in *Antitrust* magazine,[25] first noting the impressive scope of Porter's empirical study (one hundred industries in ten industrial nations) and then singling out essential thoughts of Michael Porter. Brodley summarized Porter: "To achieve global competitive advantage firms must seek 'relentless improvement.' They must invite challenge, enter the most competitive markets, [and] serve the most demanding customers . . . ."[26] Mergers and alliances "'tend to assure mediocrity, not create world leadership.' Free riding fears will not deter the progressive firm because it knows that only through sustained investment in innovation can it remain at the forefront of world competition."[27] "A benign merger policy has injured competitiveness in both the United States and Great Britain, and even Japan has faltered . . . ."[28]

Brodley accepts the Porter description and prescription. He likens Porter's remark that "'[l]oss of domestic rivalry is a dry rot that slowly undermines competitive advantage by slowing the pace of innovation and dynamism'"[29] to Judge Learned Hand's famous line that unchallenged power "deadens initiative," while "rivalry is a stimulant."[30]

How could the United States auto industry have gotten so big and so unresponsive by the end of the first decade of the 2000s, even in the face of strong foreign competition from Japan and Germany? Porter and Brodley provided an answer.

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[21] Those holding this preference would add that outcomes are presumed efficient unless proved inefficient. *See* Eleanor Fox, *The Efficiency Paradox*, *in* OVERSHOT THE MARK, *supra* note 10, at 77.

[22] PORTER, *supra* note 9.

[23] *Id.* at 117.

[24] *Id.* at 118.

[25] Brodley, *supra* note 9.

[26] *Id.* at 38.

[27] *Id.*

[28] *Id.* at 39.

[29] *Id.* at 40 (alteration in original).

[30] *Id.* (quoting United States v. Aluminum Co. of Am., 148 F.2d 416, 427 (2d Cir. 1945)).

III. WORKABLE ANTITRUST POST-CHICAGO

After *The Competitive Advantage of Nations* came *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*.[31] The steamroller of beautiful efficiency had flattened the antitrust landscape. Joe tried to unflatten it. He wrote *Post-Chicago Economics and Workable Legal Policy*[32] – discussing two concepts close to his heart. His target was explicitly not Chicago economists, but "judges who rely on decade old economic theories, uninformed by modern economic advances."[33] Seven years later, he was to write his powerful articles on price predation, proving by both facts and theory that predatory pricing does occur, is successful, and is a threat to an efficient economy; and that strategic games are played and they work.[34]

Workability of antitrust law and enforcement has always been a key concern of Joe Brodley, perhaps in part because of the challenge by Bork and others that any framework other than efficiency is "mush." Joe has proved that an antitrust welfare approach engined by rivalry is not mush. In his 1995 article, he posed six problems and offered answers.[35] These included the most daunting problems that we face today, as we are forced to realize that the austere efficiency model has failed. I note here two of the questions that Brodley posed.

> *"[I]s a price increase in the downstream consumer market the necessary condition for an antitrust violation . . . ?"*[36]

Brodley says no. The short-term view requiring price rise, he argues, "ignores the source of the heaviest penalty on economic welfare – loss of productive and innovation efficiencies. Indeed, these losses are apt to far outdistance those from static or allocative inefficiency."[37] For his example, Brodley uses *Eastman Kodak Co. v. Image Technical Services, Inc.*,[38]

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[31] 509 U.S. 209 (1993). There the Court stated, as it had before, that price predation is hardly ever tried, and when tried, is hardly ever successful. *Id.* at 226 (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588-90 (1986)). Brodley and others proved the Court wrong. *See infra* note 34 and accompanying text. Nonetheless, the Court continues to repeat the statement. *See, e.g.*, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 323 (2007).

[32] Brodley, *supra* note 8.

[33] *Id.* at 683. He may have been too generous to Chicago economists, who were quite learned in modern advances.

[34] *See* Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Response to Critique and Further Elaboration*, 89 GEO. L.J. 2495, 2496 (2001); Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239, 2242 (2000).

[35] Brodley, *supra* note 8, at 683-84.

[36] *Id.* at 683.

[37] *Id.* at 687.

[38] 504 U.S. 451 (1992).

assuming counterfactually that the price of aftermarket service had not risen. He writes:

> [C]onsumer welfare is surely vindicated when antitrust prevents exclusionary conduct that raises market-wide costs in intermediate markets. . . . [E]ven if consumers suffer no immediate injury, such cost-raising conduct must eventually reduce their welfare . . . either by raising consumer prices or sustaining existing supra-competitive prices free from challenge by more efficient rivals.[39]

Brodley concludes: "exclusionary conduct that undermines competitive conditions by destroying investment incentives, and which at the same time fails to produce any positive benefit for consumers, should be unlawful even in the absence of a predictable price increase in the impacted market."[40]

> *"[H]ow can we best deal with the fact that changes in industry structure tend to be irreversible?" And how can we avoid litigation of "efficiencies"?*[41]

Brodley observes: "Changes in market structure tend to be permanent. They cannot be unwound except at high cost."[42] Elimination of independent competitors by merger, and (for example) elimination of the independent service companies at issue in *Kodak*, may have high costs because they are not easily reversible. "[E]xclusion may foreclose development of a competitive industry in components."[43]

Enforcers, says Brodley, should favor reversible transactions over irreversible ones. They should be more accepting of joint ventures than mergers.[44] They should not shy from ordering access to essential inputs.[45] Courts should look for incentivizing "separating mechanisms" – i.e., self-enforcing mechanisms that would separate efficient action from abusive action.[46] For example, authorities might allow a merger that involves essential inputs only on condition that the firm agrees to give competitors non-discriminatory access to the input.[47] If the efficiency gains make the merger attractive to the acquiring firm even though it will not be able to use its new advantage over rivals, the prospect of the conditionality itself will cause the merging firms to choose whichever is the more efficient route – merger or no merger.

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[39] Brodley, *supra* note 8, at 688.

[40] *Id.* at 689.

[41] *Id.* at 683.

[42] *Id.* at 686.

[43] *Id.* at 687.

[44] *Id.* at 686.

[45] *Id.* at 690.

[46] *Id.*

[47] *Id.*

The decision reached in *United States v. Oracle Corp.* would later prove the point.[48] The case involved a three-to-two merger (by the better understanding of market definition or unilateral effects) in which Oracle Corporation swallowed up PeopleSoft, Inc., a major competitor, which was then lost forever.[49] Likewise, in *United States v. Microsoft Corp.*, Microsoft's strategy, which largely succeeded, was to cripple Netscape's browser, which was then the biggest challenger (by innovation) to the Microsoft operating system.[50] In Europe, Microsoft targeted Sun Microsystems and Novell, killing off innovative products.[51]

IV. AHEAD OF HIS TIME, AND THE TIME HAS COME

For decades, Joe Brodley has been proposing a workable antitrust framework that would unleash rivalry, inspire efficiency and innovation, and serve consumers. For two decades, the Supreme Court has honed and refined a "logical" antitrust model, shedding messiness and inconsistencies[52] by shrinking antitrust.[53] Only in the last two years – which, importantly, include the financial crisis, the election of President Barack Obama, and policy statements by the new Assistant Attorney General in Charge of Antitrust[54] – has there been a felt need for a new platform for antitrust analysis. The new vision must build on Chicago School insights, just as Joe always has done. But it must replace trust in dominant firms with trust in rivalry; caring as much about access, entry, and mavericks, as price.

In the last two years, we have seen the rise of the middle. I would cite the book edited by Bob Pitofsky, *How the Chicago School Overshot the Mark*,[55]

[48] United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175-76 (N.D. Cal. 2004).

[49] Oracle and SAP AG, the two biggest firms after the merger, subsequently raised prices a month apart, causing the *Wall Street Journal* to speculate that "consolidation in the industry may be easing the competition over prices that has been a hallmark of the last decade." Ben Worthen, *SAP, Oracle Boost Software Prices*, WALL ST. J., July 17, 2008, at B9. Yet, pricing would not be Brodley's principal concern. Rather, his concern would be the lost innovation. *See* Brodley, *supra* note 7, at 1021.

[50] United States v. Microsoft Corp., 253 F.3d 34, 50-79 (D.C. Cir. 2001).

[51] Case T-201/04, Microsoft Corp. v. Comm'n, 2007 E.C.R. II-3601, 3797-98, 3820-21 (upholding findings by the European Commission that Microsoft had abused its dominance by failure to provide full interconnectivity information and by bundling); Eleanor Fox, Microsoft *(EC) and Duty to Deal: Exceptionality and the Transatlantic Divide*, 4 COMPETITION POL'Y INT'L 25, 31-32 (2008) (describing the transatlantic divide between the United States and Europe in their legal approaches to duty to deal).

[52] *See* AYN RAND, ATLAS SHRUGGED 199 (1957) ("Contradictions do not exist. Whenever you think that you are facing a contradiction, check your premises. You will find that one of them is wrong.").

[53] *See* Fox, *supra* note 21, at 81.

[54] Varney, *supra* note 10.

[55] Robert Pitofsky, *Introduction* to OVERSHOT THE MARK, *supra* note 10, at 3, 3-6.

and recent articles by Alfred Kahn[56] and Irwin Stelzer.[57] The new literature challenges the hollowness of the obsessive fear of false positives and the blind trust in even monopolized markets, and highlights concern for the incentives of market players, including those without power. For many years, "rivalry" as a goal was a dirty word of antitrust, equated with protecting inefficient competitors rather than consumers. Now, the pendulum has swung so far towards protecting the dominant firm that the tide has turned.[58] It is time to return to appreciation of the dynamic efficiency function of rivalry.

Joe Brodley wrote *The Economic Goals of Antitrust* for the Airlie House conference of 1987, when liberal antitrust thinkers – many not as well attuned to the economic advances as Professor Brodley – were taking on board the then "new learning."[59] Today, twenty-three years later, as we salute Joe Brodley, we observe the excesses to which the insights of the 1980s were carried. The literature of the new-new-learning rides on the back of the scholarship of Joe Brodley.

[56] Alfred E. Kahn, Who Started It? Who Stopped It? A Modest Proposal to Reverse the Ranking of Type One and Type Two Errors in the Predation Lexicon 1-2 (Aug. 4, 2009) (unpublished manuscript, on file with author).

[57] Irwin Stelzer, *Some Practical Thoughts About Entry*, *in* OVERSHOT THE MARK, *supra* note 10, at 24, 24-29.

[58] Fox, *supra* note 21, at 80-81.

[59] *See generally* INDUSTRIAL CONCENTRATION: THE NEW LEARNING (Harvey J. Goldschmid, H. Michael Mann & J. Fred Weston eds., 1974) (compiling papers from the Arlie House Conference of 1974 on the topic of industrial concentration and antitrust policy).