Antitrust Balancing

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Introduction

Antitrust litigation often confronts situations where effects point in both directions. If every important effect pointed the same way the court could either dismiss the complaint or else apply the rule of per se illegality. In a rule of reason case, by contrast, some factors indicate competitive harm, while others indicate benefit. One controversial issue in addressing such practices is the role of balancing in Sherman Act cases under the rule of reason. Another is the standard for evaluating mergers of competitors, and whether and how claims about merger-induced efficiencies should be considered.

As a matter of statutory law and precedent these cases seem distinctive, but they have important points in common. First is a claim of competitive harm that requires the court to assess power and the severity of a competitive threat. Second, however, is a claim of an offsetting justification offered to show that the conduct is competitively harmless or perhaps even beneficial.

Judges often describe the process of evaluating these factors as “balancing.”¹ In the e-Books decision the Second Circuit believed that the need to balance is what justifies application of the rule of reason, reflecting language in Supreme Court decisions.² The court then went on to decide the case under the per se rule, however, without doing any balancing. In speaking of both §§1 and 2 of the Sherman Act in Microsoft, the D.C. Circuit stated that “courts routinely apply a …balancing approach” under which “the plaintiff must demonstrate that the anticompetitive harm… outweighs the procompetitive benefit.”³ But then it decided that case with almost no

¹ Ben V. & Dorothy Willie Professor of Law, University of Iowa. Thanks to Scott Hemphill for commenting on a draft.
³ United States v. Microsoft Corp., 253 F.3d 34, 59 (D.C.Cir. 2001). The court also indicated that the same approach should be taken under the two sections of the Sherman Act. Ibid.
balancing, giving only some general statements such as the need to “balance cost savings against reduction in consumer choice” without offering any metric for doing that. If the defendant offered a defense that was not found to be pretextual, the court simply accepted it, and it condemned behaviors for which no defense was offered. Even when courts describe this activity as balancing, they rarely discuss the impact of the restraint on prices. Many never mention prices at all. The exceptions are cases that explicitly involve price fixing or other restrictions on pricing.

While the Supreme Court has variously accepted or rejected defenses in rule of reason cases, it has only rarely described this analysis as “balancing,” and it has never actually conducted any balancing. In its Oklahoma Board of Regents decision the Court considered an NCAA-imposed restraint on live broadcasting of television games, and a defense that the policy promoted “athletically balanced competition.” Without doing any balancing, it agreed with the lower court’s conclusion that even if such a defense was legitimate it could be achieved by a less restrictive alternative. The more recent Actavis decision described earlier patent/antitrust cases as seeking to balance patent rights with the prohibitions of the Sherman Act, but it provided no instruction about how to turn those interests into units capable of being balanced. The methodology that the Court actually developed, which involved looking for payments that were disproportionately large in relation to anticipated litigation costs and the justifications for such payment, did not require balancing. The Leegin case, which applied the rule of reason to resale price maintenance, did not suggest balancing, although it did cite one economic text as indicating that the overall cost-benefit consequences of RPM are “probably close.” Other recent Supreme Court decisions overturned lower courts and insisted on the rule of reason, but without discussing balancing.

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4 Id. At 88. The court also used balancing language in upholding a Microsoft restriction on alterations to the boot sequence to the extent that it OEM changes would have made Microsoft’s own interface completely invisible. Id. at 63.
5 E.g., Hairston, supra; Tanaka, supra;
6 E.g., California Dental, supra.
7 One instance is a footnote in Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 57 n. 27 (1977), which defended the legitimacy of “balancing intrabrand and interbrand competitive effects of vertical restrictions,” but suggested no calculus for doing this. The Ninth Circuit embraced a balancing test in the California Dental decision on remand. California Dental Ass’n v. FTC, 224 F.3d 942 (9th Cir. 2000). However, the Supreme Court never embraced such balancing. California Dental Assn. v. FTC, 526 U.S. 756 (1999).
At most, “balancing” refers to a few situations where the opposing harms and benefits are so grossly disproportionate that the court regards the position of one side or the other as almost frivolous. In fact, “balancing” is a very poor label for what courts actually do. Balancing requires that two offsetting effects can each be measured by some common cardinal unit, such as dollars or tons or centimeters, and then weighed against each other. The factors that courts consider under the rule of reason rarely lend themselves to such measurement. For example, the decisions referenced above that discuss the need to balance patent rights against the prohibitions of the Sherman Act provide nothing in the way of a calculus for weighing either of these interests. At best, such “balancing” depends on a complex mixture of soft economic and even ideological judgments about the effectiveness and appropriate domain of the patent system against antitrust’s concerns to promote competition. A Ninth Circuit case considering a liquor price posting provision declared that the court must balance the state’s interest in promoting temperance against the federal interest in promoting competition.\(^\text{12}\) It’s a little like balancing pride and prejudice, or harmony and ecstasy.

Even if the things we want to balance did come in cardinal units, in most cases the courts would not have the tools to make the measurements and apply them. Instead, balancing approaches are usually “binary” rather than cardinal. They are more like off and on switches that go in one direction or the other. One important exception, discussed below, is merger analysis under the government’s Merger Guidelines.\(^\text{13}\)

**Antitrust’s Rule of Reason: Balancing and Less Restrictive Alternatives in the O’Bannon Case**

Aside from naked price fixing and market division, most agreements among competitors are addressed under the rule of reason, which requires the challenger to show that the defendants collectively have market power and that the agreement reduces or threatens to reduce competition. Today the courts pursue rule of reason analysis through a verbal sequence that goes something like this: First, the plaintiff has the burden to show a prima facie anticompetitive restraint, which requires proof of power and a threat of anticompetitive effects. At that point the burden shifts to the defendant to show some justification for the restraint. If the defendant succeeds, the burden shifts once again to the plaintiff, who can then show that the proffered justification was either a pretense or else that a substantially equivalent benefit could be achieved by a less restrictive alternative. If a less restrictive alternative is available the court condemns the restraint because the same effects could have been achieved in a less anticompetitive manner.\(^\text{14}\) If no such alternative is offered or available, the court must balance the anticompetitive effects of the restraint against the nonpretextual defense.\(^\text{15}\)

As noted above, not every case is a close one. Sometimes the interest on one side is so large or small that balancing is easy, as in the Indiana Dentists case. The Supreme Court

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\(^\text{12}\)Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 901 (9th Cir. 2008).

\(^\text{13}\) See discussion infra, text at notes __.

\(^\text{14}\) On less restrictive alternatives, see Hemphill, *supra* note __ at ___.

\(^\text{15}\) See 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶1504-1507 (3d ed. 2010).
decided that the asserted need to protect patient care did not justify a dentist group’s collective decision to withhold patient X-rays from an insurer in order to enable it to verify claims. The Court never discussed balancing.

The Ninth Circuit’s 2015 decision in O’Bannon vs. NCAA involved a player challenge to NCAA member agreements governing payment to college football players. One of these was an NCAA rule that prohibited member colleges from giving student athletes scholarship support up to the full cost of college attendance, including room, board, and collateral expenses. Rather, the agreement capped compensation at a lower amount. The other was a rule that forbade athletes from being compensated by would-be endorsers or licensees for their names, images, or likenesses. The Ninth Circuit held, first, that any rule capping athlete compensation at less than the full cost of attendance was unlawful, but that the schools could agree to cap compensation at that cost. Second, it upheld the NCAA rule forbidding compensation for individual athlete licensing of names, images, or likenesses.

The Ninth Circuit was correct on both scores. The NCAA defended the agreements by citing its historical concern to protect “amateurism,” or the nonprofessional status of collegiate athletes. A long history of antitrust disputes concerning NCAA policies had cited and approved that concern. Further, the courts had identified uncompensated play as an essential attribute of amateurism. Given that, there was a bright line to be drawn amateur and professional play. But if the defendants raised amateurism as a defense, it had to be applied consistently. The court did

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17 O’Bannon v. NCAA, 802 F.3d 1049 (9th Cir. 2015).
18 Id. at 1075-1076.
19 Id. at 1076-1078.
not balance, but rather applied a purely binary distinction between amateur and professional play as a switch.

Consider the options available to an antitrust court in this case. It could have struck down all horizontal agreements capping compensation or limiting the players’ ability to market their own names, images, and likenesses. In larger schools this would very likely have ended amateur collegiate athletics in high revenue sports, transforming the more successful players into professional athletes. In that case, incidentally, if they were to unionize any agreement they made with the universities respecting their own compensation would be assessed under the nonstatutory labor exemption to the antitrust laws, provided it was made in the context of collective bargaining.

21 The O’Bannon court could also have done what the district court did, which was require that payments for names and likenesses of at least $5000 per year of eligibility be placed into a trust account for players until after they graduated. The district court reached this conclusion by holding that the concerns with amateurism were legitimate, but that the trust account was a less restrictive alternative.22 But what the court did was just price regulation by another name. Why should that amount be set at $5000 per year? Why should it be payable only in the future? The district court’s solution may have been a sensible negotiating compromise, but that is not what we mean by a “less restrictive alternative” under antitrust’s rule of reason.

Third, the court could simply define what it means to be an “amateur” athlete, relying on a line of cases stretching back to the Supreme Court’s 1984 decision in the Oklahoma Board of Regents case.23 That status operated as an important fence post, identifying a dividing line that had frequently been cited both by the courts and the NCAA’s own standards. For that, “uncompensated” play meant just that: NCAA members could not collectively suppress compensation below the cost of education, but neither could they agree to more. “Balancing” was not necessary, or else it meant nothing more than accepting the NCAA’s concerns about amateurism as legitimate and identifying the spot that best satisfies it.

To be sure, we may think there are other problems at work here. For example, some colleges and universities earn millions of dollars from their high profile football and basketball programs, essentially taking a free ride on the backs of their student athletes. Further, paying them more may be a way of preventing collegiate superstars from quitting school early in order to play professionally. This is just another way of saying that antitrust cannot correct every market irregularity. Any government imposed fix that regulates the compensation of student athletes should come from Congress.

Mergers, Prima Facie Illegality, and Efficiencies

Prior to revised Merger Guidelines issued during the Reagan administration the antitrust law of mergers was much like rule of reason analysis in Sherman Act § 1 cases today. The

23See decisions cited in note __, supra.
courts spoke in broad terms about “injury to competition” or “protecting” competition rather than competitors, but the references were vague and almost never accompanied by a useable unit of measurement. Over a series of increasingly pointed revisions, however, the Merger Guidelines have re-defined the goal as proscribing mergers that realistically threaten higher consumer prices. Mergers may also produce offsetting efficiencies, but these efficiencies will be credited only if they are sufficient to offset any price increase that the merger threatens.

The Guidelines provide merger policy with something that the Sherman Act rule of reason lacks – namely, an approach that makes balancing at least theoretically possible. Mergers are subjected to a structural or behavioral test under either a coordinated effects theory or a unilateral effects theory, whose models predict the likely post-merger price increase after providing a generalized “credit” for efficiencies. In litigation, that test represents the Government’s prima facie challenge to the merger on the theory that prices are likely to rise. If the test is met then the burden shifts to the defendant to show efficiencies beyond the credit that the government gives in the prima facie case. These efficiencies must be both merger specific, which means that they would not likely occur absent the merger, and also of sufficient magnitude to reduce the predicted price to no higher than premerger levels.

Although the Merger Guidelines give the Agencies some wiggle room, their stated test for competitive harm approximates a “consumer welfare” standard. In antitrust parlance, “consumer welfare” measures the impact of a practice on consumers, ignoring offsetting producer gains. By contrast, a “general welfare” test nets consumer losses and producer gains against each other, proclaiming a practice to be efficient if producer gains exceed consumer losses. While the Guidelines never speak expressly of “consumer welfare,” they do make post-merger price increases the central standard for assessing merger illegality. A merger is lawful only if, after efficiencies are considered, consumers are unharmed.

The Government’s approach under the Guidelines has provoked the criticism that the government’s burden in making out a prima facie case is relatively simple, relying mainly on

structural evidence and predictions extrapolated from observed responses to price changes, while the defendants must provide concrete evidence of offsetting efficiencies.  

That criticism is not well founded, however. First of all, when the government makes a prima facie case it already takes into account what might be considered “ordinary” or typical efficiency gains that mergers are likely to produce. Particularly for unilateral effects mergers it uses a presumptive formulation, assuming efficiency gains of as much as ten percent. The efficiencies defense is thus relevant only for substantial efficiencies that exceed those already accounted for in the government’s evaluation.

Second, efficiencies relate to the production and distribution processes of the merging firms themselves, so this information is uniquely in their possession. Further, firms are responsible to their shareholders and the failure rate for mergers is quite high. A large percentage of acquiring firms lose money both in the short and middle term after a merger. As a result one must presume that firms research very carefully before making an acquisition. At least the acquiring firm should have pretty good information about the source of any increased profits from a merger. The burdens that the law assigns are consistent with the types of information that the parties control.

One additional rather sobering fact is the record of post-merger pricing. In 2007 the Antitrust Modernization Commission suggested that empirical studies be done concerning post-merger price and output performance. Several of these studies have now been done, but before we can draw strong conclusions we need to do more. The studies examine “marginally legal” mergers – that is, mergers that were close to the threshold for illegality under Guidelines’ standards at the time that they were examined but were allowed to proceed, in some cases after partial divestitures or other relief. The majority of these studies reveal post-merger price

28.E.g., in re Ardagh Group, S.A., 2014 WL 1493617 (FTC Apr. 11, 2014) (Wright, Com’r, dissenting) (protesting that “the burden facing the agency with respect to the likelihood of anticompetitive effects should be in parity with that faced by the parties with respect to efficiencies”).
increases, some of them substantial. The methodologies of some of them have been criticized, however, and clearly more work needs to be done.\textsuperscript{33}

In any event, assuming that a significant portion of these studies are correct, several alternative explanations could be considered. The most obvious one is that that the standards for prima facie illegality articulated in the Guidelines are too lenient. As a result too many harmful anticompetitive mergers are permitted. Another is that the government’s blanket presumptions about merger efficiencies are too generous. It is unlikely, however, that post-merger price increases occur because the government has accepted efficiency defenses too readily. In fact very few merging parties have succeeded in proving offsetting efficiencies sufficient to undermine a prima facie case against a merger.

The Merger Guidelines as currently formulated are an instance of balancing done right, which is not to say that it is easy. First, stating consumer price increases as the principal concern creates a unit of measure that makes balancing at least conceptually possible.

Second, whatever the relative advantages or disadvantages of a consumer welfare test, the fact is that the consumer price test articulated in the Guidelines is easier to administer than a general welfare test. In order to estimate general welfare effects one must be able to quantify consumer harm, which includes not only higher prices but also deadweight loss. This requires information about the shape of the demand curve. In addition, offsetting efficiencies must be assessed and netted out. This requires a court to look not only at per unit cost savings, but also at the output over which those costs will be spread. If the merger actually raises prices, then any achievable efficiencies will have to occur at lower output levels than prior to the merger. While that is hardly impossible, the range of efficiencies available at a reduced output is significantly less than the range that results from an output increase.\textsuperscript{34}

By contrast, the consumer price approach taken in the Guidelines requires the purely “vertical” query how much did the merger tend to push prices up, and what is the downward cost adjustment resulting from the efficiencies. In most cases, both of those numbers are much easier to determine.

Conclusion

Whether the Merger Guidelines approach to balancing can be migrated to general antitrust litigation under the rule of reason depends on the challenged practice. Joint ventures with efficiency potential but threatening higher prices from collusion are a likely candidate. Practices that threaten exclusion will be more difficult to evaluate. Practices whose consequences show up in the longer run will be particularly difficult, as well as practices for which the defense has little to do with measurable prices.

\textsuperscript{33} Gregory J. Werden, Inconvenient Truths on Merger Retrospective Studies, 3 J. ANTITRUST ENFORCEMENT 287 (2015).

\textsuperscript{34} See Hovenkamp, Appraising Merger Efficiencies, supra note __ at __.
In the vast majority of rule of reason cases, even complex ones such as *O’Bannon*, real balancing is not necessary. The series of steps – first prima facie case, then defense, and occasionally inquiry into less restrictive alternative – will be sufficient. Care must be taken to ensure that the defense is one that is really specific to the challenged practice – that is, that the efficiencies could not be earned otherwise than by the challenged venture. In addition, the tribunal must be sure that proffered less restrictive alternatives ameliorate our competitive concerns and are realistically available. Close cases should be relatively rare, and courts should lean toward dismissal when markets are poorly defined or shares are on the lower edge of illegality.

Finally, it is important not to forget that historically the equitable power of courts has been greater in §1 cases than in merger cases, and can be asserted over a wider range. As a result, remedies can be much more modest or more finely calibrated. For example, the remedies in the *Board of Regents* and the *O’Bannon* cases were not to dissolve the NCAA or force divestitures, but rather to enjoin enforcement of the rules limiting the number of televised games in the first case, or the agreements limiting compensation in the second. This “*cy pres*” power of judges should not be overlooked. Just as contractual arrangements come in infinite varieties they can also be fixed in infinite ways.

35 *See* Hemphill, *supra* note __.