

NOTE

ANTITRUST AND POSITIONAL ARMS RACES

The idea of “winner take all” markets, or harmful “positional races” as the phenomenon is sometimes called,¹ directly clashes with the philosophy of antitrust regulation.² Antitrust law advocates competition as the means of achieving its ultimate goal of maximizing welfare.³ “Positional” competition, however, often produces suboptimal results.⁴ Should antitrust law apply to winner-take-all markets, or should this field be left to other governmental regulation?

This Note addresses the relevance of antitrust regulation to winner-take-all markets and proceeds as follows: Part I describes the phenomenon of suboptimal winner-take-all markets, sometimes called “arms races” because they spur participants to race for supremacy. Part II draws the basic lines of relevant antitrust law and considers “arms control agreements” as a tool for mitigating this kind of market failure. Part III is dedicated to a short, positive analysis of such agreements under Section 1 of the Sherman Act. In Part IV, some thoughts on normative and institutional reasons underlying the analysis in Part III are presented. Finally, Part V outlines the conclusions.

I. HARMFUL RACE TO THE TOP

Everybody loves a winner, and the market often agrees, granting enormous rewards for those who win. While the best players win big, others are left behind, reaping rewards that bear little relationship to how close they were to winning or to the magnitude of the difference between their talents and those of the

1. See ROBERT H. FRANK & PHILIP J. COOK, *THE WINNER-TAKE-ALL SOCIETY* (1995) (describing the phenomenon of winner-take-all markets, examining its origins and features, and proposing some solutions).

2. See *id.* at 225–27.

3. See *id.* at 177–78, 225–27.

4. See *id.* at 10–11.

winners. The phenomenon of winner-take-all markets has received extensive attention since the 1980s.⁵ In these markets, a large number of entities compete for a relatively small number of positions that offer the possibility of financial rewards far exceeding those that await less successful competitors.⁶ Absent significant spillovers, the outcome in many such markets is socially undesirable: new entrants produce a negative externality by reducing the chances of other participants to receive a reward.⁷ Markets for sports, entertainment, legal services, and education have many features of winner-take-all markets.⁸

Why is the outcome produced by these markets inefficient? It might be beneficial from a productive point of view because fierce competition produces the best talents and products. Absent such high rewards, the pools of candidates to become the next Michael Jordan, Tiger Woods, or Madonna would be considerably smaller, meaning the top performers would be inferior in comparison with the current level.⁹ This outcome, however, is inefficient from an allocative perspective: human resources, money, and time invested in the “race to the top” cost more than the marginal value of the top players’ improved performance.¹⁰ This situation is known as an “arms race:” although perfectly rational from the private perspective, the choice to put in additional effort in hopes of becoming the best produces a socially inefficient outcome when the costs of the “race” are at least partially non-recoupable.¹¹ Why would individuals enter the market? The rational explanation is that before entry occurs, the expected benefit is higher than real and opportunity costs given the existing level of salaries and com-

5. See DEREK BOK, *THE COST OF TALENT* (1993) (discussing increasing inequality in compensation and rising costs of education in the American economy); FRANK & COOK, *supra* note 1; Sherwin Rosen, *The Economics of Superstars*, 71 *AM. ECON. REV.* 845 (1981).

6. FRANK & COOK, *supra* note 1, at 24.

7. *See id.* at 108–09.

8. *See id.* at 2–3, 11–14, 16–17, 23–26.

9. *See id.* at 102.

10. *See id.* at 108–09.

11. *See* FRANK & COOK, *supra* note 1, at 108–09, 126–31. It is a variation of the famous “prisoners’ dilemma,” sometimes called “a dollar auction,” when an asset is auctioned between two players and the “twist” is that both the winner and loser pay. Absent enforcement or repeated plays, rational actors are expected to play until they reach their wealth constraint. *See* Martin Shubik, *The Dollar Auction Game: A Paradox in Non Cooperative Behavior and Escalation*, 15 *J. CONFLICT RESOLUTION* 109 (1971).

petition.¹² Post-entry, continuing to invest in improved performance is also perfectly rational—the expected marginal benefit of effort is, indeed, higher than the cost.¹³ The irrational explanation for market entry is an overestimation of one's chances to win, which is quite typical for human beings.¹⁴

From an economic standpoint, a market for positional goods presents another application of zero-sum games.¹⁵ Once individuals are in the market and relative positions are established, additional investment in positional goods is mutually offsetting because the value derived from pure positional goods comes entirely from the relative positioning. In aggregate, the additional investment is waste. A positional good provides at least some utility to the owner through the indirect benefit of signaling his status in society. The world is replete with positional goods—yachts, mansions, engagement rings, education, advertisement—each of which is valued by buyers according to its relative, marginal features in comparison with other goods. The “positional goods race” is a zero-sum game.

II. ARMS CONTROL AGREEMENTS

From the outset, it must be made clear that winner-take-all markets are not always bad. Patent law, for example, facilitates a winner-take-all structure of reward for invention by granting monopoly rights in an invention to the first entrepreneur who completes it.¹⁶ The organization of network industries is also

12. See FRANK & COOK, *supra* note 1, at 106–09.

13. See *id.* at 127–31.

14. See *id.* at 103–05. Numerous psychological studies show that individuals systematically tend to overestimate their own abilities. See Colin Camerer & Dan Lovallo, *Overconfidence and Excess Entry: Experimental Approach*, 89 AM. ECON. REV. 306 (1999) (explaining excessive optimism in the market entry context).

15. See FRANK & COOK, *supra* note 1, at 127–31.

16. Of course, it can be argued that because of an *extremely* unequal system of rewards, where all benefits of inventions are extracted by the winner, the market of patentable research and invention is the ultimate waste producing market. The traditional justification for granting a legal monopoly to a patent owner is that the benefits produced by research and development are significantly higher than the loss from the “race to the patent.” See, e.g., Donald F. Turner, *The Patent System and Competitive Policy*, 44 N.Y.U. L. REV. 450, 451–52 (1968). For a proposal to recognize independent invention as a defense against a patent infringement suit (and thereby reduce incentives in the “race to the patent” in those cases where the probability of independent invention is relatively high, and, therefore, the need for patent law is questionable), see generally Samson Vermont, *Independent Invention as a Defense to Patent Infringement*, 105 MICH. L. REV. 475 (2006). For an eco-

similar to winner-take-all markets. In these industries, a dominant player wins most of the market due to significant demand-side economies of scale from standardization.¹⁷ In both examples, the winner-take-all structure is often beneficial. For patents, there would be considerably less investment in riskier inventions absent the possibility of such high returns.¹⁸ In network industries, standardization is extremely efficient and can be more easily achieved with a single firm dominating the market.¹⁹

The arms races addressed throughout this Note, however, do not produce such social gains. Instead, winner-take-all markets in higher education, media advertisement, and markets for star players are typically undesirable as measured by total welfare. The welfare effects of arms control in such markets, including potential harm to desirable competition, however, may differ. Besides allowing for reallocation of otherwise wasted resources into more productive industries, agreements may serve other positive goals, like making education more affordable to low-income students in case of higher education, or improving quality of news coverage in case of voluntary codes of behavior adopted by the media companies.

An alternative of regulation by impartial and accountable actors, however, may be a more beneficial or politically acceptable result than self-regulation by the industry. On the other hand, this might not be always the case. For instance, in the communications industry, active intervention of government in media content can be undesirable from a public policy perspective;²⁰ putting a cap on executives' salaries, proposed from time to time during the recent debate on executive compensation, is

conomic model of the interplay between the recognition of legal rights in patents ("prior user rights") and economic efficiency both ex ante (incentives to invent) and ex post (welfare loss in monopoly compared to oligopoly), see Carl Shapiro, *Prior User Rights*, 96 AM. ECON. REV. 92 (2006).

17. See generally THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION AND POLICY 414-23 (John E. Kwoka & Lawrence J. White eds., 2004); A. Douglas Melamed, *Network Industries and Antitrust*, 23 HARV. J.L. & PUB. POL'Y 147, 147-48 (1999).

18. See Turner, *supra* note 16, at 450-51.

19. See Melamed, *supra* note 17, at 148-49.

20. Unlike in other industries, there is an added value in the non-interference of government in the functioning of the free press. Such a rationale does not exist in industries where decision-making about regulatory choices can be made solely on the basis of cost-benefit economic analysis.

actually a tariff regulation, condemned by generations of economists.

All of these factors may lead to different outcomes for arms control agreements in antitrust analysis. Moreover, notwithstanding the same purpose and effect, some agreements may be condemned as illegal per se (without a court's inquiry into the proposed justifications), while others may be reviewed under the "rule of reason" by balancing anticompetitive and procompetitive effects.²¹

After a short presentation of antitrust law on "restraints of trade," the following Subpart will discuss some typical "arms control" arrangements and will attempt to predict their treatment by antitrust law.²²

A. *Rule of Reason*

Section 1 of the Sherman Act provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."²³ Notwithstanding the statutory language of "every contract," the Supreme Court, in its early landmark antitrust decisions, limited the statutory prohibition to unreasonable restraints.²⁴ Reasonableness analysis concentrates on the effects of a challenged practice on competition, weighing its possible anticompetitive effects against procompetitive justifications.

Since the early days of the Sherman Act, antitrust review of restraints on trade has been conducted through per se illegality rules or the rule of reason.²⁵ Per se illegality applies to the practices perceived as so clearly anticompetitive (like price-fixing,

21. See WILLIAM C. HOLMES, *ANTITRUST LAW HANDBOOK* 194–95 (2006).

22. Controlling wasteful arms races may also be accomplished through social norms. Although non-legal restrictions are not currently reviewed by antitrust law, there are proposals to review social norms as "agreements." For a proposal to treat some social norms as antitrust violations, see Dean Harvey, *Anticompetitive Social Norms as Antitrust Violations*, 94 CAL. L. REV. 769, 789–91 (2006).

23. 15 U.S.C. § 1 (1997).

24. See *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49–50 (1977) (citing *Standard Oil & Co. v. United States*, 221 U.S. 1, 66–68 (1911)).

25. See *id.* "Rule of reason" terminology was first used in *Mitchel v. Reynolds*, (1711) 24 Eng. Rep. 347 (K.B.), one of the first English common law decisions on restraints of trade. See ABA ANTITRUST SECTION, *MONOGRAPH NO. 23, THE RULE OF REASON* 23 (1999) [hereinafter *THE RULE OF REASON*].

market division, or output limits)²⁶ that no justifications based on their business (or social) virtues are accepted.²⁷

In the course of a rule of reason inquiry, the court weighs possible anticompetitive effects against procompetitive effects of the practice.²⁸ Various relevant factors, such as the intent and purpose of the restriction, the market structure, barriers to entry, and efficiencies, are taken into account.²⁹ If procompetitive justifications substantially outweigh the harm to competition, and no plausible and less harmful alternative exists, the practice is reasonable and legal.³⁰ Rule of reason analysis dominates today; application of per se rules is rather limited.³¹ The costs of chilling legitimate economic and commercial activity are great under extensive application of per se rules.

So what are the advantages of per se rules? Why not always prefer more precise, careful rule of reason analysis adjusted to specific industry circumstances? Traditional answers appeal to business certainty, the competence of the courts, and reducing the costs of adjudicating complicated factual questions of harm to competition.³² Obviously, some of the practices that would survive rule of reason analysis are condemned under the per se illegality rule.

Under a rule of reason analysis, the adverse effect on competition is usually established either by proof of a “naked restraint” such as price-fixing, where the harm to competition is presumed, by proof of an actual effect on competition, or by proof that the restraint will make it easier to exercise market power.³³ Procompetitive virtues of restraints can vary, including “increasing output, creating operating efficiencies, making a new product available, enhancing product or service quality, and widening consumer choice.”³⁴ The defendant must show

26. See Louis Kaplow & Karl Shapiro, *Antitrust* 52 (John M. Olin Center for Law, Economics and Business, Discussion Paper No. 575, 2007), (forthcoming in HANDBOOK OF LAW AND ECONOMICS (A. Mitchell Polinsky & Steven Shavell eds., 2007)), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/Kaplow_Shapiro_575.pdf.

27. See *Continental T.V.*, 433 U.S. at 49–50.

28. HOLMES, *supra* note 21, at 194–95.

29. *Id.*

30. See *id.* at 196–97 n.3.

31. *Continental T.V.*, 433 U.S. at 49–50.

32. See *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 343–44 (1982).

33. HOLMES, *supra* note 21, at 197–98, 206–09.

34. *Law v. Nat’l Collegiate Athletic Ass’n*, 134 F.3d 1010, 1023 (10th Cir. 1998), *cert. denied*, 525 U.S. 822 (1998).

that there is a substantial connection between the restraint in question and the procompetitive justifications presented.³⁵ If a less restrictive alternative exists, however, the restraint is considered unreasonable.³⁶

The emphasis of the rule of reason is on how the challenged practices influence competition. Notwithstanding more than a century of antitrust jurisprudence, however, the meaning of “competition” as a normative goal of antitrust laws remains unclear. Does it have any inherent value or is its importance solely instrumental? One of a few generalizations that can be derived is that competition is viewed as a process, and the result achieved by competitive powers simply cannot be “unreasonable.”³⁷ However, another “instrumentalist” approach to competition, in which a restraint significantly enhancing welfare can be found reasonable, is also possible and may be distilled from some cases.³⁸

B. Implications

1. Higher Education

*United States v. Brown University*³⁹ provides an illustration of the antitrust law view of arms-control agreements. In 1991, the Department of Justice sued MIT and eight Ivy League colleges for an alleged violation of the Sherman Act by engaging in a conspiracy to restrain competition for students receiving financial aid.⁴⁰ One of the defendants’ arguments in court was that without the collective action there would be less financial aid available to needy students, with a resulting decrease in the

35. HOLMES, *supra* note 21, at 196–97 n.3.

36. *Id.* However, the restraint does not have to be “essential.” See *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 296 (1985).

37. For a discussion of case law, see HOLMES, *supra* note 21, at 215–19, and Kaplow & Shapiro, *supra* note 26, at 55–56. See also Joseph Farrell & Michael Katz, *The Economics of Welfare Standards in Antitrust*, 2 COMPETITION POL’Y INT’L 3 (2006).

38. See, e.g., *Broad. Music, Inc. v. CBS*, 441 U.S. 1 (1979). Although the court did not justify its decision in welfare-enhancing terms, if the traditional “competition process” approach would be applied, the agreement would be condemned as unreasonable. The Court’s “new product” argumentation seems to be stretching the definition of “productive cooperation” unreasonably wide.

39. 5 F.3d 658 (3d Cir. 1993).

40. Gustavo E. Bamberger & Dennis W. Carlton, *Antitrust and Higher Education: MIT Financial Aid (1993)*, in JOHN E. KWOKA, JR. & LAWRENCE J. WHITE, *THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY* 188, 188 (4th ed. 2004).

number of low-income students attending the schools.⁴¹ MIT was found liable by the district court.⁴² Soon after, Congress passed the Higher Education Act, allowing certain cooperative conduct aimed at concentrating aid only on needy students.⁴³ The next year, the court of appeals overturned the district court's verdict and ordered a new trial.⁴⁴ The Department of Justice subsequently dropped all investigations and reached a settlement with MIT that allowed most of the conduct previously challenged.⁴⁵

The challenged agreements may be easily analyzed in winner-take-all terms.⁴⁶ A university's reputation depends in large measure on its ability to attract the best students.⁴⁷ Absent externally imposed constraints, the schools will do their best to attract such students, including reallocating financial aid accordingly.⁴⁸ Under such an approach, financial aid will be tunneled disproportionately to students with the highest grades and not to those in need.⁴⁹ Indeed, the disputed policy worked to the disadvantage of the most talented candidates, but it is the very goal of financial aid to make education available to talented, low-income students. As the importance of rankings in education increases,⁵⁰ competition among universities has shown many visible winner-take-all features: the best institutions, although arguably only slightly better than those ranked slightly below, enjoy an incomparable quality of candidates and much higher alumni donation rates.⁵¹ Curbing some of the other aspects of zero-sum competition among higher education institutions, like limiting investment in certain kinds of facilities and activities, could be very helpful.

41. *Id.*

42. *Id.* at 189. The rest of the defendant schools signed a consent decree. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. See Robert H. Frank, *Higher Education: The Ultimate Winner-Take-All Market?* 3, (Cornell Ctr. for the Study of Inequality Working Paper, 2001), available at http://inequality.cornell.edu/publications/working_papers/RobertFrank1.pdf. For a short discussion of economics of not-for-profit education, see Bamberger & Carlton, *supra* note 40, at 188.

47. See Frank, *supra* note 46, at 4–5.

48. See *id.* at 10.

49. See *id.*

50. See *id.* at 5.

51. See *id.* at 1–3, 9–11.

2. *Voluntary Corporate Codes of Behavior:
the Example of Media Codes*

Social responsibility codes accepted voluntarily by businesses are becoming more and more popular.⁵² In addition to non-commercial motivations, other reasons to adopt such codes may include better public relations or prevention of more intrusive governmental regulation. Self-regulation of the media markets is one example.

Television markets have many positional features.⁵³ For many viewers, the relative quality of the program matters as much as its absolute quality.⁵⁴ Media companies are all aware of this fact. One possible result is a race to the bottom in terms of excessive violence and sensationalism.⁵⁵ Unrestricted competitive forces lead to a result of inadequate content for children, scandal-like treatment of politics, and a negative impact on social norms and human preferences generally.⁵⁶ A code of conduct, enforced by a kind of industry-wide association, has been proposed by some policymakers and representatives of the industry as a solution.⁵⁷ The provisions of the code may include a responsible representation of violence, substantive and issue-oriented news coverage, and a certain mandatory minimum of educational programming.⁵⁸ This arrangement would prevent a zero-sum competition, in which the stations that take more and more extensive efforts to attract viewers get a competitive advantage only for a short period, until their competitors respond.⁵⁹ This kind of competition, besides its inefficiency, is especially undesirable because of the negative social impact.

3. *M & H Tire v. Hoosier: Parity Promotion*

In *M & H Tire Co. v. Hoosier Racing Tire Corp.*, the plaintiff, a producer of tires, challenged the limitations on the quality of racing tires imposed by the association of drivers and track

52. See Cass Sunstein, *Television and the Public Interest*, 88 CAL. L. REV. 499, 551–52 (2000).

53. See *id.*

54. See *id.* at 551.

55. See *id.* at 550–51.

56. See *id.* at 551.

57. See Sunstein, *supra* note 52.

58. See *id.* at 553–55.

59. See *id.* at 558–59.

owners in certain areas of New England.⁶⁰ The restriction bound the racers to use a single brand of racing tires during one year.⁶¹ The district court decided that the limitation was either horizontal and illegal per se or anticompetitive under a rule of reason analysis.⁶² The court of appeals reversed the judgment.⁶³ First, it held the agreement was vertical and required a rule of reason analysis.⁶⁴ Second, the court conducted a rule of reason inquiry and balanced possible anticompetitive effects against the virtues of setting “rules of the game” and the cost-saving justification, concluding that the restraint passed scrutiny.⁶⁵

The restriction imposed by the association in *M & H Tire* was a typical arms control agreement.⁶⁶ In this case, some individual racers found out that they could gain an edge by spending more than their rivals on new designs of tires.⁶⁷ To curb this arms race, the association adopted the rules specifying that all must compete with identical brands and models of tires, and required the tire producers to submit their bids.⁶⁸ The winning bidder was announced, and one of the aspects of the positional arms race was solved.⁶⁹ Among the arguments in defense of the single-tire rule accepted by the court of appeals was that the arrangement promoted parity between the racers, switching the focus of competition from purely technical features of the cars to the racers’ skills.⁷⁰ Two qualifications must be added, however, about the general potential of implementing *M & H Tire* to justify more lenient antitrust treatment of arms control agreements. First, one of the reasons why the restraint was not declared a per se violation was

60. 733 F.2d 973, 974 (1st Cir. 1984).

61. *Id.* at 974–75.

62. *Id.* at 976–78. Vertical restraints are imposed by suppliers on wholesalers, by wholesalers on retailers, and visa versa; horizontal restraints are imposed on each other by competitors. See PHILIP E. AREEDA & HERBERT HOVENKAMP, 2 FUNDAMENTALS OF ANTITRUST LAW, 583–85 (2005); THE ANTITRUST REVOLUTION, *supra* note 17, at 322–23.

63. *M & H Tire*, 733 F.2d at 989.

64. *See id.* at 978–84.

65. *See id.* at 984–89.

66. *See* FRANK & COOK, *supra* note 1, at 226.

67. *See id.*

68. *See id.*

69. *See id.*

70. *See M & H Tire*, 733 F.2d at 976, 980, 986.

its vertical structure.⁷¹ Second, the parity promotion point may also be understood as applying specifically to sports self-regulation.⁷²

4. *Self-Limitations on Advertising*

In *National Society of Professional Engineers v. United States*, the Supreme Court struck down a rule of ethics of the national engineers association that banned competitive bidding for the provision of services by members.⁷³ One of the justifications offered by the defendants, and rejected by the Court, was market failure arguably leading to excessive price competition and inferior engineering work.⁷⁴ In its decision, the Court expressed confidence in free competition producing lower prices and better goods and services, concluding that “the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.”⁷⁵

Twenty years later, the Supreme Court upheld limitations imposed by the California Dental Association on the content of advertising by its members.⁷⁶ The relevant rule of ethics restricted advertising relating to price and quality of dental services.⁷⁷ The majority rejected a “quick look” rule of reason analysis⁷⁸ made by the court of appeals and concluded that, absent obvious anticompetitive effects and given plausible pro-competitive justifications, full-scale rule of reason analysis was more appropriate.⁷⁹

Let us change some facts and assume that the restraint was put not on the content but on total annual advertising expenses. The argument would be that an advertising positional

71. *See id.* at 978–79.

72. On the other hand, the sports regulation context may be relevant to a more reluctant use of per se illegality presumptions, without effect on rule of reason balancing. *See id.* at 980–81.

73. 435 U.S. 679, 679, 681, 683 (1978).

74. *See id.* at 693–96.

75. *Id.* at 694–96.

76. *Cal. Dental Assoc. v. FTC*, 526 U.S. 756, 759 (1999).

77. *See id.* at 760–62.

78. “Quick look” or “truncated” analysis is somewhere between “Rule of Reason” and *per se* treatment. *See* THE RULE OF REASON, *supra* note 25, at 135–39. Applied to agreements on price or output, which are usually condemned as illegal *per se*, a “quick look” at the business justification for the restraint may result in a full rule of reason analysis.

79. *See Cal. Dental Assoc.*, 526 U.S. at 763, 778–81.

race results in a zero-sum game and social waste: after an increase in advertising by several members, others do exactly the same, and total expenses on advertising grow, while relative positions of the rivals stay the same. Absent significant advantages to the customers from such increased spending, which seems questionable in an aggressive advertising case, the outcome is suboptimal. The procompetitive virtue of the restraint could be its focus of competition on other aspects, like price or quality. Would this kind of restraint be declared illegal *per se*? If analyzed under the rule of reason, how would the case be decided?

III. ANTITRUST ANALYSIS

Not surprisingly, antitrust law does not treat all positional arms control agreements equally. The underlying logic of a differential approach is clear. Antitrust aims to promote welfare through competition. Anticompetitive effects of different peace treaties intended to limit arms races may vary significantly, and sometimes a positional race argument is just a sham to cover a hardcore cartel constructed to raise prices, limit output, and transfer wealth from consumers to the industry. More than that, the results of an antitrust review may depend on identity of the party imposing restraint. An alternative, powerful explanation of the underlying antitrust principles is distrust of trade regulations by financially interested and unaccountable actors.⁸⁰ This view may presuppose a discrepancy in the weight given to positional race arguments as well—the stronger the direct financial interest of the restraining body in imposing restraint, the less weight will be given to it by courts.

The limited competence of courts—with generalist judges and juries charged with specialized fact-finding—may pose another obstacle to consistent treatment of positional race justifications. While the adverse effects of positional races in education⁸¹ and mass media⁸² are obvious, their deleterious effects on other markets are less salient, necessitating more sophisticated analysis. Hence, as a matter of institutional competence, positional race justifications may be acceptable only when anti-

80. See generally, Einer Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667 (1991).

81. See Frank, *supra* note 46, at 3.

82. See Sunstein, *supra* note 52, at 501.

competitive effects are insignificant, as with vertical restraints⁸³ or when additional, socially desirable effects are present.⁸⁴ In other words, positional race justifications are only desirable when the costs of false negatives are low.⁸⁵

A. *Per Se Illegality or Rule of Reason?*

Although curbing positional races is possible through vertical restraints,⁸⁶ horizontal agreements between competitors are arguably more effective.⁸⁷ One must first ask, however, whether horizontal restraints are per se illegal. This Subpart will now consider three examples of horizontal arms control arrangements: financial aid arrangements, codes of behavior, and limitations on advertising.

It is clear that each of these arrangements could produce anticompetitive effects. Competition for the students with the best grades (as a group) becomes less intensive; TV channels compete less for “hot,” speculative information; and members of an industry or profession are limited in their ability to expose themselves to a large group of potential clients by advertisement. In each of these cases, the procompetitive justification is that, by preventing zero-sum races, the focus switches to price and quality, arguably increasing competition along these axes. It seems like none of these restraints advances productive collaboration between the rivals;⁸⁸ perhaps a code of behavior can be counted as a socially responsible (and hence new) “product.”⁸⁹ If a restraint is on price—absent productive procompetitive justification—it will be invalidated. Conversely, if

83. See *M & H Tire Co. v. Hoosier Racing Tire Corp.*, 733 F.2d 973, 978 (1st Cir. 1984).

84. See *United States v. Brown Univ.*, 805 F. Supp. 228, 307 (E.D. Pa. 1992).

85. See generally, Frank Easterbrook, *Limits of Antitrust*, 63 TEX. L. REV. 1, 15–17 (1984). False positive errors occur when liability is imposed on innocent persons; false negative errors occur when a guilty party escapes liability.

86. See *M & H Tire Co.*, 733 F.2d at 980.

87. More importantly, most potential vertical restraints are already reviewed under Rule of Reason analysis. See HOLMES, *supra* note 21, at 224–34. The only exception is vertical minimum price maintenance, which is still seen as per se illegal. See RICHARD A. POSNER, *ANTITRUST LAW* 188–89 (2d ed. 2001).

88. HOLMES, *supra* note 21, at 206–09.

89. This argument is rather weak. An analogy may be taken from the mergers regulation where “organizational innovations” and “best practices,” if not protected by copyright, are not counted in merger-specific efficiencies. See DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, *COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES* 50–51 (2006).

parties are traditionally involved in self-regulation, and restraints do not involve prices, output levels, or direct financial interest, the agreement will be reviewed under the rule of reason. All three of our hypotheticals fall into this latter scenario and, therefore, would probably be upheld. With respect to the first hypothetical, in the *Brown University* case, the universities' tuition revenue was supposed to remain the same.⁹⁰ Regarding the second hypothetical, media companies do not benefit financially from adopting codes. Finally, a limitation on wasteful advertising is unproblematic as long as the imposing body is a professional association.⁹¹ There is another side to this story, however. In a universe without positional arms races, competitors are better off financially because they would avoid the expenses associated with zero-sum competition. Thus, the absence of financial interest here may not be so clear.

*B. Rule of Reason Balancing, Collective Action,
and Welfare Justifications*

Rule of reason analysis involves analyzing the challenged agreement by weighing anticompetitive effects against procompetitive, efficiency-oriented justifications. Even the competition on quality and price argument discussed above can be framed as an evaluation of expected anticompetitive effects: none of the restraints in the three examples cited in the previous section significantly harm the total mix of competition in the industry.

One must remember that, if the challenged agreement is aimed to curb an arms race, then market power—a necessary prerequisite of anticompetitive effects—may be presumed. If an entity lacks market power, then it is unlikely to be subjected to arms control, and a positional race justification does not make sense.

A distinguishing feature of the positional race argument is that a restraint in question prevents socially inferior (although competitive) outcomes. Although sometimes the restraints yield at least partially non-commercial benefits to society in

90. See Bamberger & Carlton, *supra* note 40, at 202.

91. Fashion Originators' Guild of Am. v. FTC, 312 U.S. 457 (1941) (declaring illegal policing of producers "free riding" on original designs); Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 700 (1978) (demonstrating a more flexible analysis of horizontal restraints between professionals); FTC v. Ind. Fed. of Dentists, 476 U.S. 447, 458–59 (1986) (same).

whole, this need not be the case.⁹² Even if most (or even all) of the surplus resulting from a shift to a more efficient outcome is extracted by the restraining party, the goal of curbing a wasteful race would still be reached.

A defining characteristic of this theory is that a race to the top generates social waste. Presented in this manner, the theory directly collides with the reasoning in *Professional Engineers* that, under a rule of reason analysis, defenses based on assumption of unreasonable competition are inadmissible. However, *California Dentists* substantially narrowed the scope of this rule. In *California Dentists*, the restraint was designed to treat a market failure following from the consumers' informational disadvantage; this argument, according to the court, was admissible and required serious analysis.

The case of media content regulations seems easiest to predict. In the past, restrictions on tobacco advertisements have been upheld as reasonable and in service of the public interest.⁹³ Here, the specifics of the media market, coupled with the absence of any direct financial interest on the part of the channels, indicates that a court would likely uphold the legality of the regulation.

One can also analyze the positional theory as a social welfare justification. One could say that arms control agreements are aimed to promote welfare and enhance allocative efficiency by preventing waste; in this scenario, gains in total welfare may outweigh any possible harm to competition.

The status of non-commercial, social welfare justifications in antitrust law is unclear.⁹⁴ The public safety arguments offered by the defendants in *Professional Engineers* and *FTC v. Indiana Federation of Dentists* were rejected by the courts;⁹⁵ in *FTC v. Superior Court Trial Lawyers Association* the court did not accept an argument that boycotts promoted better legal service to crimi-

92. For examples of this, see *United States v. Brown Univ.*, 805 F. Supp. 228 (E.D. Pa. 1992) and the media hypotheticals that were mentioned previously.

93. See *American Brands, Inc. v. Nat'l Ass'n of Broadcasters*, 308 F. Supp. 1166, 1169 (D.D.C. 1969); *AFL-CIO v. Nat'l Ass'n of Broadcasters*, 407 F. Supp. 900, 903 (S.D.N.Y. 1976).

94. See, e.g., Lee Goldman, *The Politically Correct Corporation and the Antitrust Laws: The Proper Treatment of Noneconomic or Social Welfare Justifications Under Section 1 of The Sherman Act*, 13 YALE L. & POL'Y REV. 137 (1995). For a summary of case law related to social justifications, see THE RULE OF REASON, *supra* note 25, at 116-19.

95. *Ind. Fed. of Dentists*, 476 U.S. at 463-64 (1986); *Nat'l Soc'y of Pro'l. Eng'rs*, 435 U.S. at 695-96.

nal defendants.⁹⁶ In *Arizona v. Maricopa County Medical Society*, the policy considerations could have justified the physicians' scheme in the name of improved health care.⁹⁷

Conversely, in the *Brown University* case, the court validated a challenged agreement because it promoted education for low-income students.⁹⁸ In the context of professional self-regulation, courts are more receptive to social welfare arguments;⁹⁹ however, the doctrine in this area is far from stable.

C. *Self-Regulation and Conflict of Interests*

The positional races phenomenon is a market failure requiring regulation; it is one of those exceptional cases when the outcome resulting from unrestricted competition is only second-best, leading to social waste and suboptimal resource allocation.¹⁰⁰ Should courts rely on self-regulation to constrain positional races? And, correspondingly, should courts accept the winner-take-all market argument under rule of reason?

There are several substantive reasons to doubt that private actors can effectively regulate markets. First, if private actors have a financial interest in the relevant industry, one must worry about conflicts of interest. Second, private players are politically unaccountable. Finally, relying on private regulation opens the door for private actors to further selfish causes under the guise of public service.

On the other hand, when deciding how to balance government and private regulation, one must consider the inherent limits of public regulatory intervention. First, private players, due to their access to information, are better equipped to identify market failures and to prepare timely and fitting responses. Second, public regulation is costly: efficient regulation of changing markets requires significant bureaucratic expenditure. Third, and most importantly, public regulators are often captured by the regulated industries; and worse, the more specific the regulation,

96. 493 U.S. 411, 424 (1990).

97. 457 U.S. 332 (1982).

98. See *United States v. Brown Univ.*, 5 F.3d 658, 677-79 (3d. Cir. 1993).

99. See *Goldman v. Va. State Bar*, 421 U.S. 773, 788 n.17 (1975); *Cal. Dental Ass'n v. FTC*, 526 U.S. 756 (1999) (offering a holding that may support more lenient treatment of social welfare-based restraints imposed by professional associations).

100. See W. KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., *ECONOMICS OF REGULATION AND ANTITRUST* 313-16 (2000).

the higher the chance of capture.¹⁰¹ Thus, limited private regulation, with reasonable restrictions supervised by courts, may be a better solution to market failure.

It is also important to understand that achieving regulatory intervention may be costly and time-consuming. Sometimes interest groups are able to slow down legislation, making it expensive and in some cases even impossible. In this case, a judicial grant of antitrust immunity to private activity aimed to deal with market failure is likely to be held in violation of basic principles of government and separation of powers. It may be argued, however, that nothing in the Sherman Act or in settled principles of antitrust regulation *at least theoretically* prevents the courts (and regulators, if authorized) from incorporating efficiency considerations into the rule of reason formula.¹⁰²

*D. Administrative Efficiency, Institutional Competence,
and Structure of Antitrust Review*

Administrative efficiency, availability of remedies, and the limited institutional competence of courts bear the underlying responsibility for the current form of antitrust rules.¹⁰³ Absent decision-makers' errors and adjudication costs, full-scale inquiry into effects on competition is always preferable to presumptions, safe harbors, and other rule-like law provisions, which are inevitably overinclusive or underinclusive. Still, in the real world, where getting to all relevant circumstances, details, and subtleties of the case is costly and time-consuming and where the decisions are made by erring judges and juries, use of narrow rules is inevitable.

The economic principles of antitrust law justify *per se* treatment of horizontal agreements by avoiding costly inquiries into competitive effects. Non-ancillary restraints on price, output, or market share have severe anticompetitive effects in the vast

101. See, e.g., Sam Pelzman, *Toward a More General Theory of Regulation*, 19 L. J. & ECON. 211 (1976). "Regulatory capture" theory, however, is applicable to antitrust as well. See William E. Kovacic, *Public Choice and the Origins of Antitrust*, reprinted in *THE CAUSES AND CONSEQUENCES OF ANTITRUST* 243–53 (Fred S. McChesney & William F. Shugart eds., 1995).

102. For a contrary view, rejecting welfare justifications of non-competitive character and arguing that an important feature of antitrust is a competitive process, see Farrell & Katz, *supra* note 37.

103. See POSNER, *supra* note 87, at 259–86; OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 282–85 (1996).

majority of cases,¹⁰⁴ without generally realizing any social efficiency. Exempting such restraints from a per se rule, given positional externality (or another market failure justification),¹⁰⁵ may raise the costs of antitrust review significantly. More than that, given the costs and unavoidable errors involved with conducting economic analysis of positional race theory in every case, the costs of false negatives in public regulation could be substantial. Thus, direct regulation of price or output in winner-take-all markets appears to be preferable to self-regulation.¹⁰⁶

Admissibility of positional theory in rule of reason analysis will, at most, only minimally raise costs of administration. Reasonableness inquiries already require more sophisticated analysis involving econometric evidence and expert opinions. Adding a positional race factor to existing analysis should not be too costly.

The limited competence of generalist courts to respond to a dynamic economic environment, however, combined with ex-post structure of antitrust review by adjudication, may provide a serious counterargument to adopting a new defense. In the United States, antitrust regulation is executed mainly through the courts. A winner-take-all, socially inferior outcome may be just a temporary phenomenon in the market, and restraint—reasonable and aimed at fixing market failure before and during the trial—may become undesirable over the course of time.¹⁰⁷ In other words, effective regulation may require intensive supervision of changing market conditions and responsive adjustments of restraint. This concern favors public over pri-

104. Additionally, there is emerging empirical evidence of harms incurred by “hardcore” cartels. See John M. Connor, *Price-Fixing Overcharges: Legal and Economic Evidence 2* (Purdue Univ., Staff Paper No. 04-17, 2005), available at <http://www.agecon.purdue.edu/staff/connor/papers/>.

105. For a proposal to regulate market externalities by a more lenient treatment of price-fixing and monopolization in industries, see Peter J. Hammer, *Antitrust Beyond Competition: Market Failures, Total Welfare, and the Challenge of Intermarket Second-Best Tradeoffs*, 98 MICH. L. REV. 849 (2000) (also extending analysis to mergers regulation); Christopher R. Leslie, Note, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price-Fixing*, 81 CAL. L. REV. 243 (1993).

106. Possible regulatory practices are taxing consumption and subsidizing or mandating purchase of non-conspicuous goods. See Richard H. McAdams, *Relative Preferences*, 102 YALE L.J. 1, 69–90 (1992). Section 401(k) tax benefits and limits on deductibility of managers’ compensation not based on performance under the Internal Revenue Code indirectly serve such a purpose.

107. However, this critique similarly applies to antitrust litigation-based regulation in any dynamic industry. See, e.g., POSNER, *supra* note 87, at 276–79.

vate regulation. Regulatory agencies are much better equipped than courts to monitor dynamic markets and properly design rules aimed at fixing market failure.

A flipside of ex post review is the enormous deterrent effects of antitrust liability. If declared illegal per se or unreasonable, an arms control agreement would expose the parties to treble damages in private action and criminal sanctions in a government suit. Given this chilling effect, the chances that private parties will adopt arms control agreements are slim. This probability is further reduced in cases where private actors reap only a fraction of the surplus resulting from an agreement and a positive externality benefiting third parties is produced. When parties to agreement are unlikely to realize much of the surplus gains, they are unlikely to adopt socially beneficial restraints. In such situations, favorable treatment of social welfare justifications (that will respectively reduce liability concerns) could be helpful.¹⁰⁸

In defense of a positional race justification, it may be added that the requirement of institutional competence here does not differ from similar requirements in other efficiency (procompetitive) contexts like merger cases. Efficiency justifications assessed by courts frequently require complex economic analysis; in other cases, the dynamic nature of the market also leads to a high probability of errors.¹⁰⁹ Still, generalist courts are considered competent enough to review efficiency justifications in mergers control and procompetitive virtues in rule of reason cases.

On the other hand, recognition of winner-take-all arguments may lead courts down a slippery slope toward legitimizing “bad competition” defenses. However, acceptance of winner-take-all arguments only from the financially disinterested parties dwarfs the scope of the positional argument and limits it to strictly “non-commercial justification” cases like the *Brown University* case, consequently mitigating the slippery slope concern. Setting the boundaries within the professional self-regulation sphere makes positional defense more narrow and applicable; nevertheless, it is unclear why, among the professionals, positional race has more destructive results (and, there-

108. It may be argued that in such situations the parties have less financial interest and thus the chances that the parties will exercise restraint are higher. However, *some* financial interest still exists in these situations.

109. See POSNER, *supra* note 87, at 276–79.

fore, review of agreements limiting arms races must be more lenient)¹¹⁰ or why potential anticompetitive effects (which in any case would have to be taken into account under rule of reason analysis) are less severe.

Allocating proper roles between courts and regulators is probably the strongest argument against giving weight to the positional defense in antitrust. Fixing market failures with economic regulation falls traditionally within the purview of the legislative and executive branches.¹¹¹ When antitrust doctrine goes too far and excessive competition results in market failure, usually Congress reacts fast enough and immunizes the activity from antitrust enforcement.¹¹² Hence, absent governmental action¹¹³ directly or implicitly limiting antitrust application, inventing market failure defense would contravene the accepted model of separation of powers in the regulatory sphere.

IV. CHANGING SOME VARIABLES

Three arguments against employing market failure factors, and positional races in particular, in antitrust law are especially powerful: ensuring a proper separation of powers between the judicial and executive branches, the greater economic competence of regulators (in comparison with generalist courts), and the ex post nature of American antitrust review.

Indeed, given the American institutional design of antitrust enforcement, positional race defenses, like other market failure defenses, do not fit into antitrust doctrine. At best, a winner-take-all market structure may be considered under rule of reason analysis. Even then, however, some qualifications distinguishing between financially interested and uninterested parties may arise. Even if an arms control agreement is reviewed under the rule of reason, the specter of treble civil

110. Distributional concerns are a possible answer.

111. On the economic regulatory process in the United States, see generally VISCUSI ET AL., *supra* note 99, at 13–46.

112. For an overview, see Dennis W. Carlton & Randall C. Picker, *Antitrust and Regulation* (Univ. of Chicago Law Sch., John M. Olin Law & Econ. Working Paper No. 312, 2006); see also Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335.

113. Concerted lobbying to achieve such governmental action is immune under the “petitioning immunity” doctrine. See *United Mine Workers of Am. v. Pennington*, 381 U.S. 657, 670 (1972); see also Einer Elhauge, *Making Sense of Antitrust Petitioning Immunity*, 80 CAL. L. REV. 1177, 1177–78 (1992).

damages and criminal liability may over-deter socially beneficial restraints. Without restrictions on parallel private suits, executive antitrust agencies, potentially capable of efficiently monitoring the activity in question, cannot significantly mitigate the excessive deterrence potential by executing their prosecutory discretion.¹¹⁴ More than that, in the United States, because of the litigious nature of antitrust law, horizontal agreements¹¹⁵ are not reviewed *ex ante*; it is impossible for the party to obtain a pre-ruling on the merits. Hence, absent such a mechanism, a private party capturing only a fraction of the social benefits of the restraint will effectively be deterred from adopting it.

The underlying tradeoffs between public antitrust regulation and self-regulation in American antitrust law do not necessarily exist in other jurisdictions.¹¹⁶ For instance, if antitrust regulation is performed by a professional agency and reviewed by an independent court, the institutional competence criticism becomes irrelevant. Similarly, when industry-specific agencies' professionalism and free-market orientation are questionable, as in the case of some transitional economies,¹¹⁷ incorporating market failure variables into antitrust analysis may be beneficial. The size of the economy,¹¹⁸ the level of economic development,¹¹⁹ and the weight of political factors in antitrust enforcement¹²⁰ may change our propositions regarding the availability and desirability of effective industry regulation, the effects of regulatory capture of agencies, and other factors defining assignment of market regulation.

114. While the total sum of expected sanctions decreases, given the remaining deterrent potential of treble damages, the change in overall sanction is too small.

115. Notably, some horizontal mergers requiring notification and approval of antitrust agency are excluded from this rule. See Clayton Act, 15 U.S.C.A. § 18a(c)(7) (2007) (the "Hart-Scott-Rodino Act").

116. See Michal S. Gal & Inbal Fainbish, *Six Principles for Limiting Government-Facilitated Restraints on Competition*, 44 COMMON MKT. L. REV. 69 (2007).

117. *Id.*

118. See MICHAL S. GAL, *COMPETITION POLICY IN SMALL MARKET ECONOMIES* 1 (2003).

119. See David Van Zandt, *Competition Law and Policy in Flux: The Developing Country Experience*, 26 NW. J. INT'L L. & BUS. 493, 493 (2006).

120. Michal S. Gal, *Reality Bites (or Bits): The Political Economy of Antitrust Enforcement*, in INTERNATIONAL ANTITRUST LAW AND POLICY (Barry Hawk, ed.) 605, 605-16 (2002).

For example, if advanced ruling on the legality of restraint can be provided by the antitrust regulation, then we can think of several flexible arrangements balancing a need to regulate winner-take-all markets and the hazards associated with abuse of this justification by self-interested private parties. One option would be approving certain restraints ad hoc with an option for review within a defined period of time.

Another option may be an ad hoc sunset exemption, which expires after a certain period. There are at least two clear benefits of this approach. First, self-regulation by an industry may be used as a trial run of subsequent governmental regulation. It may be a timely and efficient reply to market failure. Second, during this interim, anticompetitive effects can be monitored more effectively. Given the tentative nature of this exemption, self-regulating parties will think twice before abusing their power.

Political and distributive objectives of antitrust law are largely swept aside in the United States, but are highly relevant in other jurisdictions. Antitrust can reduce excessive political power of dominant corporations,¹²¹ and it can distribute wealth through lower consumer prices or revenue collection through fines.¹²² The primary effect of winner-take-all markets, especially in the context of the service industry, is redistributive and not welfare-reducing; by concentrating revenue in the upper echelon, winner-take-all markets increase inequality. Thus, if redistribution through antitrust is desirable, treatment of positional races indeed deserves special, more fine-tuned treatment.

121. See, e.g., Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1051, 1064 (1979) ("It is bad history, bad policy, and bad law to exclude certain political values in interpreting the antitrust laws A striking feature of the legislative history of amended section 7 was the widely-shared perception of danger to the political well-being of the country and its citizens stemming from the merger movement"); see also Louis B. Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076, 1078 (1979) ("But clearly the dominating motivation was political: a desire to create alternative centers of power that could not readily be marshaled behind authoritarian regimes.").

122. If the taxation system is highly inefficient, such a mechanism can be justified from the welfarist's point of view: total loss resulting from inefficient outcome can be smaller than benefit produced by a transfer of wealth from rich to the poor. Given the diminishing utility of income, under some assumptions such an outcome is the achievable "second best." For a discussion of normative goals of antitrust, including redistribution of income, see Kenneth G. Elzinga, *The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?* 125 U. PA. L. REV. 1191, 1191, 1194 (1977).

Concern with extreme concentration of economic power in too few hands may dictate a more interventionist approach, aimed at creating (or maintaining) markets with multiple participants. Proponents of this approach would necessarily be very suspicious of private self-regulation.

V. CONCLUSION

In the near future, winner-take-all and positional race phenomena will become relevant for even more markets.¹²³ It is not clear whether, according to current doctrine, antitrust enforcement must be more careful in such environments. The brief analysis conducted in this Note leads to the conclusion that, given the welfare-enhancing goals of antitrust, some changes to current practices are normatively desirable. The unique institutional structure of antitrust in the United States, however, may be a serious obstacle to adopting such changes.

*Michael Sabin**

123. Among the factors supporting this prediction are the informational revolution of the last decade, globalization, and liberalization of economies around the world. See ROBERT H. FRANK, *LUXURY FEVER: MONEY AND HAPPINESS IN AN ERA OF SUCCESS* 33, 39, 41–42 (1999).

* Harvard Law School, Fellow, John M. Olin Center of Law, Economics, and Business; LL.M. Candidate (expected 2007). Thanks to the John M. Olin Center for financial support.