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DODGING THE CONSUMER HARM INQUIRY: A BRIEF SURVEY OF RECENT GOVERNMENT ANTITRUST CASES

DAVID S. EVANS†

INTRODUCTION

The antitrust laws should stop business practices that harm competition or distort the competitive process. If the courts—or economists—knew the precise design of the “competitive process” that maximized consumer welfare, we could simply prohibit practices that deviate from competitive norms. Unfortunately, economists do not have a “competitive process bible”—a list of thou shall nots.

Businesses are always coming up with new ways of competing. The competitive process in high-technology industries is vastly different than that in agriculture. The competitive process in biotechnology is very different than that in software. The only trustworthy way of finding out whether business practices harm consumers is to examine their impact on

† Senior Vice President, National Economic Research Associates, Inc. This paper is based on remarks I made at the Yale Club of New York City, Antitrust Conference, November 30, 2000. I would like to thank Stephen Bomse, Thomas Brown, Howard Chang, and William Rooney for helpful discussions, as well as Kirstyn Walton for research assistance. I have consulted for Microsoft and Visa on the matters discussed below but the opinions expressed here are mine alone.
consumers. Have they raised prices, restricted output, or reduced quality? Or will they?

Theory alone usually cannot answer those questions. The Supreme Court sent that message loudly and clearly in California Dental Ass’n v. FTC—there must be empirical evidence.\(^1\)

The companion papers by Messrs. Houck, Joffe, and Rooney show widespread agreement that the purpose of the antitrust laws is to protect consumers.\(^2\) However, the big cases that the Federal Trade Commission (FTC) and the U.S. Department of Justice have actually brought in the last few years present many excuses for why plaintiffs should not have to come up with hard evidence that the defendant has harmed consumers—or ever will.

I. LEGAL BACKGROUND

There is little dispute that the antitrust laws exist to protect competition and consumer welfare. Some commentators, nonetheless, have argued that there is “no requirement of proof of actual harm to consumers—beyond that of injury to competition.”\(^4\) The argument is that “[p]roof of actual consumer harm is not required because it is inferred from injury to competition” and because “competition benefits consumers.”\(^5\) This inference, however, holds true only under limited circumstances. The Court has ruled that per se offenses, such as price fixing, are agreements “whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are ‘illegal per se.’”\(^6\) Thus, proof of consumer harm is unnecessary since harm can be presumed under most circumstances.

\(^1\) 526 U.S. 756 (1999).
\(^2\) See Cal. Dental Ass’n v. FTC, 526 U.S. 756, 759 (1999) (holding that a thorough inquiry into actual consequences of anticompetitive effects is necessary where the effects are “far from intuitively obvious”).
\(^4\) Houck, supra note 3, at 8.
\(^5\) Id.
On the other hand, agreements analyzed under the rule of reason "can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed." Thus, because there is no presumption of consumer harm for rule of reason agreements, plaintiffs must show consumer harm. And while "naked" price and output restraints analyzed under a "quick look" version of the rule of reason may not require a "detailed market analysis," this is only appropriate when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."

Although inferences of consumer harm are permitted under limited circumstances, the Supreme Court has made clear that it is actual harm to consumers that really matters. This can be seen in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, where the Court discussed what was needed to show consumer harm in a predation case. Predation takes place when a firm sets low prices to drive competitors out of business, so that it can then set high prices and recoup its earlier losses. As the Court found, it is not enough to show that an alleged predator charged low prices (for that is also the hallmark of competition, not predation); a plaintiff must also show that the alleged predator "had a reasonable prospect, or, under section 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices." The Court was quite clear that it was not enough to show that competitors were driven out of business, which the enforcement agencies would likely view as harm to competition or harm to the competitive process. The

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7 *Id.*
9 *Id.* at 770.
11 Cal. Dental, 526 U.S. at 770.
13 *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993) ("First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs.").
14 *Id.* at 224.
Court explained that a plaintiff must show that there would ultimately be consumer harm in the form of higher prices:

If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely injure competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it. As we have observed on a prior occasion, "[i]n order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices."

The recent California Dental decision is also helpful in understanding the semantic confusion between "harm to competition" and "harm to consumers." The FTC had argued that certain advertising restrictions—including restrictions affecting price advertising—adopted by a dentist association in the face of new entry. But it was unable to demonstrate that American set prices below average variable cost, the measure commonly adopted by courts, or that American would be able to recoup its alleged losses from these lower prices according to the district court that dismissed the government's case. The government argued that American had nevertheless engaged in predation because it made less money than it could have (that is, sacrificed short-run profits), added capacity to serve the increased demand, and developed a reputation for predation that deterred entry in many markets. In dismissing the government's novel predation test, the court observed:

A rule of predation based on the failure to maximize profits would rob consumers of the benefits of any price reductions by dominant firms facing new competition. Such a rule would tend to freeze the prices of dominant firms at their monopoly levels and would prevent many pro-competitive price cuts beneficial to consumers and other purchasers.

In rejecting the government's reputation argument, the court noted:

A fundamental principle of antitrust law is that it be capable of effective and accurate administration, and not chill the competition it seeks to foster. The government's reputational liability approach would violate this principle, permitting claims of predation based solely upon the subjective and unverifiable complaints of a defendant's competitors.

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Id. at 1201 (citing MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1114 (1983)). In rejecting the government's reputation argument, the court noted:

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AMR, 140 F. Supp. 2d at 1218.

California were anticompetitive. It was so sure of its case that it did not even have an economist testify that consumers had been harmed. In some literal sense, it could certainly be argued that advertising restrictions restrained competition—competitors certainly faced restrictions on the type of advertising they could engage in. In the absence of empirical evidence, that literal argument fails to show that consumers were harmed.

The Ninth Circuit affirmed the FTC's decision, but it was overturned by the Supreme Court. The Court rejected the characterization of the advertising restrictions as naked restrictions on price and insisted on actual evidence, especially empirical evidence, of consumer harm:

But these observations brush over the professional context and describe no anticompetitive effects. Assuming that the record in fact supports the conclusion that the CDA disclosure rules essentially bar advertisement of across-the-board discounts, it does not obviously follow that such a ban would have a net anticompetitive effect here. Whether advertisements that announced discounts for, say, first-time customers, would be less effective at conveying information relevant to competition if they listed the original and discounted prices for checkups, X-rays, and fillings, than they would be if they simply specified a percentage discount across the board, seems to us a question susceptible to empirical but not a priori analysis.

[Justice Breyer] thinks that the Commission and the Court of Appeals "adequately answered that question," ibid, but the absence of any empirical evidence on this point indicates that the question was not answered, merely avoided by implicit burden shifting of the kind accepted by JUSTICE BREYER. The point is that before a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of procompetitive effects, as quick-look analysis in effect requires, there must be some indication that the court making the decision has properly identified the theoretical basis for the anticompetitive effects and considered whether the effects actually are anticompetitive. Where, as here, the circumstances of the restriction are somewhat complex, assumption alone will not do.

On remand, the Ninth Circuit was forced to look at the facts

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18 Id. at 774 (emphasis added).
19 Id. at 775 n.12 (emphasis added).
in the record and ruled against the FTC.\textsuperscript{20} Unfortunately, the FTC had lost its chance to submit empirical evidence to prove its case. \textit{California Dental} may thus help to convince the enforcement agencies that they should not bring cases unless they are prepared to prove consumer harm through better evidence than they have offered in the last few years.\textsuperscript{21}

\section*{II. FTC v. Intel Corp.}

Consider the FTC’s case against Intel Corporation ("Intel").\textsuperscript{22} Intel refused to share its intellectual property with three companies that had sued it for patent infringement, and the FTC claimed that this helped Intel maintain a monopoly in chip making. The FTC said that this suppressed innovation. The FTC told us:

While [the FTC] must demonstrate that Intel’s conduct was harmful to competition in the sense that it was “reasonably capable” of making a significant contribution to preserving Intel’s dominance, \textit{it is not necessary to demonstrate that Intel’s conduct resulted in increased prices or lower output.}\textsuperscript{23}

The FTC used the bolded phrase as an excuse for not presenting any evidence that Intel’s actions had, or ever would, have significant adverse effects on consumers. It did not have evidence on whether Intel’s actions had reduced the rate of innovation, lowered prices, restricted output, or could have ever done so as a factual economic matter. The FTC did not offer any factual evidence that consumers would benefit from lower prices, greater output, or more rapid innovation if Intel ceased the conduct. Instead, the FTC’s factual evidence of harm seemed to be based on the observation that the three companies that were denied access to advance technical information were

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{20} See id. at 943 (holding that the FTC failed to prove anticompetitive restrictions).
\item \textsuperscript{21} The Justice Department’s case against American Airlines, discussed above in note 15, was dismissed in part because the government failed to provide any evidence in support of its monopolization by reputation theory. See United States v. AMR Corp., 140 F. Supp. 2d 1141, 1218 (D. Kan. 2001).
\end{itemize}
\end{footnotesize}
disadvantaged. \(^{24}\) The FTC’s case settled shortly after its economist acknowledged in deposition that there was no direct evidence at all that Intel’s actions had any anticompetitive effects. \(^{25}\)

### III. United States v. Visa U.S.A. Inc.

Now consider the Justice Department’s case against Visa U.S.A. Incorporated (“Visa”). \(^{26}\) (MasterCard is also a defendant, but I refer only to Visa for simplicity). Visa is a joint venture of banks. The joint venture manages and nurtures the brand. It also operates the physical network for processing card transactions, though it does not set any prices. The banks compete for individuals to take cards and merchants to accept them. \(^{27}\) Now, American Express wanted Visa banks to issue American Express cards as well as Visa cards. Note the phrase “as well as,” not “instead of.” American Express only wanted a bank if it also belonged to the Visa system. Visa told its members they could not belong to Visa if they issued American Express cards. The Justice Department claimed this was an antitrust violation. \(^{28}\)

This claim would appear to be susceptible to proof by direct evidence. If Visa let American Express into the tent, would that result in a significant net increase in the number of cards and would that lead to lower prices to cardholders? That is the kind of question that economists can really sink their teeth into. The following type of language should be a clear signal that the plaintiff wants to duck the consumer harm inquiry:

To show consumer harm, it is not necessary to prove precisely what choices consumers would have made, precisely how

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\(^{24}\) Id.


\(^{28}\) The Justice Department also objected to “duality”—the fact that banks could belong to both Visa and MasterCard associations. Duality resulted from the Justice Department’s failure in the mid-1970s to agree to Visa’s pleas to prevent it. See Evans & Schmalensee, supra note 27, at 267–75. The associations, Visa in particular, have come close to ending duality as a practical matter. The Justice Department wanted to prevent them from ever going back.
individual firms would have tried to respond to consumers, or whether they would have won or lost the competitive battle; it is sufficient to prove that the challenged restraint had a significant impact on the process by which competitive decisions were made.29

And sure enough, in 227 pages of written testimony, the Justice Department’s economist never addressed the basic issue of whether consumers would get significantly more cards or lower prices.30 For example, the following discussion transpired during the direct testimony of Michael Katz.

Q. Now, turning to another point, I looked through your direct testimony, Professor Katz, and I didn’t find any attempt by you to quantify the number of cards that you would expect to be issued in the event that the rules were to be eliminated. Am I correct that —

A. Yes, there is no attempt by me to make a prediction about the number of cards, that’s correct.

Q. Let me ask you, have you measured in an empirical way any price increases in this case?

A. In terms of the narrow conception of pricing, how a price change has gone from a particular number of dollars and cents to another, no.31

In fact, Katz did not come up with any qualitative estimates of the extent to which prices or output would change and had no factual basis for opining about consumer harm. The government made other statements that have come to characterize this genre of antitrust claims, such as antitrust is really about preserving “consumer choice” and preserving the “competitive process.”32 But when agencies immediately disavow the need to present evidence of consumer harm after repeating those phrases, they are substituting slogans for analysis.33

31 Trial Testimony of Michael Katz at 3728 (No. 98-7076) (July 12, 2000), Visa U.S.A., Inc., Trade Cas. (CCH) ¶ 72, 584 (S.D.N.Y. 1999).
33 The court adopted the rule of reason, stating that “[u]nder the rule of reason, the Government bears the initial burden (by preponderance of the evidence) of demonstrating that each restraint has substantial adverse effects on compensation
ANTITRUST CASE SURVEY

IV. UNITED STATES V. MICROSOFT CORP.

Now let us take a look at United States v. Microsoft Corp. Microsoft Corporation ("Microsoft") integrated browsing software into its operating system. The government (here the Justice Department and the nineteen state co-plaintiffs) said that tying was illegal. Microsoft invested hundreds of millions of dollars into making a high-quality browser. It then invested even more in order to make it the standard by giving it away for free. The government said that was predation and Judge Jackson concurred. But I do not want to debate the merits of the government's case. Rather, I focus on how the Justice Department attempted to show consumer harm. Professor Frank Fisher had the major responsibility for presenting the government's economic case. According to him, "The presumption of antitrust policy is that competition itself brings consumer benefits, and the lessening of competition brings consumer harm. Hence, plaintiffs are required to show an injury to competition rather than immediate harm to consumers."

This line of reasoning became an excuse for substituting rhetoric for hard evidence during the trial. For example, Professor Fisher offered this opinion:

You know, Jacques Brel says that they want to color the World the color of goose shit. If Microsoft forced upon the world one browser, that would make it really simple. That's not what competition is about. That's not what helping consumers is about. Giving choice is what competition is about.

Professor Fisher acknowledged that Microsoft had not harmed consumers up to the time of trial.

such as increase in price or decrease in quality." United States v. Visa U.S.A., Inc. 163 F. Supp. 2d 322, 345 (2001). The court, however, found Visa's restrictions on issuance of American Express cards by Visa members to be anticompetitive even though the government and its expert had not presented evidence demonstrating "substantiality." Id.


35 See Conclusions of Law at 20–21 (Nos. 98-1232; 98-1233), Microsoft, 97 F. Supp. 2d 59.


Q. At the present time, have—in your analysis—consumers been hurt by Microsoft's conduct?

A. On balance?

Q. Yes.

A. That's very hard to know. The reason that it's mostly hard—on balance, I would think the answer was no, up to this point. The reason for that is that Microsoft has used its power to protect its operating system's monopoly from a threat that might not have materialized by this time anyway. And, in doing that, it has given away a lot of things.¹

He has since pointed out that in predation cases harm comes in the future. True enough. But we have known since Brooke Group that that does not give the plaintiff a license to assume consumer harm. Rather, the plaintiff must demonstrate that the predator could plausibly expect to recoup its losses. That would have required the Justice Department to look at the likely state of competition in the market for operating systems in the future. It also would have required them to look into whether Netscape could have plausibly succeeded in the absence of Microsoft's actions. Because such inquiries were never conducted, Judge Jackson did not have much of a factual basis for concluding that Microsoft's actions—on balance—caused consumer harm in the past, present, or future. A careful reading of his Findings of Fact demonstrates the trouble he had doing so. The following table summarizes Judge Jackson's perceived consumer benefits and harms:

Table 1: Consumer Benefits and Harms Identified by Judge Jackson

<table>
<thead>
<tr>
<th>Consumer Benefits</th>
<th>Consumer Harms</th>
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<tr>
<td>Consumers who used browsers and would have paid for them benefited from lower prices for browsing software. (FOF ¶ 408) These benefits were as much as $79 for some consumers.</td>
<td>Consumers who did not want any browser were harmed because Windows 98 came with an integrated browser. (FOF ¶ 410)</td>
</tr>
<tr>
<td>Consumers who used browsers benefited from higher quality of browsing software. (FOF ¶ 408)</td>
<td>Consumers who wanted Navigator were harmed because Microsoft made it more difficult to acquire a copy of Navigator. (FOF ¶ 410)</td>
</tr>
<tr>
<td>Consumers who used browsers benefited from greater availability of browsing software. (FOF ¶ 408)</td>
<td>Consumers who preferred IE may still have been harmed from a greater likelihood of browser crashes &quot;to the extent that browsing-specific routines been commingled with operating system routines to a greater degree than is necessary to provide any consumer benefit.&quot; (FOF ¶ 174)</td>
</tr>
<tr>
<td>Compaq paid lower prices because of its &quot;support of Microsoft's Internet strategy.&quot; To the extent that the plaintiff's allegation is taken as true that reductions in price are passed through to end users, Compaq purchasers benefited. (FOF ¶ 232 -235)</td>
<td>Consumers who wanted more Java applications were harmed because there were fewer Java applications as a result of Microsoft's actions. (FOF ¶ 411)</td>
</tr>
<tr>
<td></td>
<td>Consumers who would have benefited from the video and graphics features included in Intel's NSP and who did not get them were harmed. (FOF ¶ 410)</td>
</tr>
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<td></td>
<td>IBM and Gateway were harmed because they paid relatively higher prices as a result of their &quot;reluctance&quot; to help Microsoft &quot;capture browser share.&quot; To the extent that the plaintiff is correct that higher prices are passed through to end consumers, IBM and Gateway consumers were harmed. (FOF ¶¶ 235 -238)</td>
</tr>
</tbody>
</table>

Source: Findings of Fact, U.S. v. Microsoft (No. 98-1232) (November 5, 1999) [here referred to as FOF].

Judge Jackson recognized that Microsoft's actions delivered great benefits to consumers by lowering browser prices, improving browser quality, and expanding browser output. He then identified discrete groups of consumers that were harmed. These are mainly consumers who did not want a browser and got stuck with a wad of unwanted Internet Explorer code on their

40 See id. ¶ 410.
machines. There could not have been many of those consumers, so Judge Jackson does not have any basis for concluding that consumers were harmed on balance—he was not given testimony that would enable him to do that. One might think he could have gotten himself out of this hole by finding that consumers could have benefited from lower prices or greater output in the future, yet he recognized that there was no basis for concluding that any of the competitive threats to Microsoft would have materialized.41

In the end, Judge Jackson substituted rhetoric for direct evidence of consumer harm. He found that Microsoft had denied “consumer[s] choice,” “distort[ed] competition,” and “stifl[ed] innovation.”42 These are the catch phrases that we see whenever a plaintiff lacks direct evidence that consumers, overall, have been injured.

V. THE INNOVATION GAMBIT

The enforcement agencies also used another dodge to avoid the presentation of direct evidence of consumer harm: the claim that the challenged practices harm innovation. The agencies then hide behind the difficulty of proving harm to innovation. The Justice Department’s case against Visa highlights the problem. The Department had an enormous record that it scoured for evidence of suppressed innovation. It turns out that American Express had entered into a lot of deals with banks outside of the U.S. Furthermore, another practice that the government was challenging—something known as duality—had been in place for decades.

The Justice Department, however, came up with little evidence of suppressed competition that they were willing to

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41 Judge Jackson noted, “There is insufficient evidence to find that, absent Microsoft’s actions, Navigator and Java already would have ignited genuine competition in the market for Intel-compatible PC operating systems.” Id. ¶ 411.

42 Id. ¶¶ 411–12. The D.C. Circuit concluded that most of the antitrust violations found by Judge Jackson did not “withstand appellate scrutiny.” United States v. Microsoft Corp. 253 F.3d 34, 105 (D.C. Cir. 2001) cert. denied, 122 S.Ct. 350 (2001). The D.C. Circuit also vacated the remedies ordered by Judge Jackson in their entirety and remanded them to the district court “to determine the propriety of a specific remedy for the limited ground of liability which we have upheld.” Id. at 107. The D.C. Circuit did affirm some of Judge Jackson’s monopoly maintenance findings, without subjecting those findings to a serious consideration of whether the allegedly anticompetitive actions resulted in substantial harm to customers.
offer. Instead, when Janet Reno announced the case, she merely stated that consumers would have had smart cards years ago if Visa and MasterCard had not suppressed innovation:

America's consumers have lost out. They have lost the benefit of vigorous competition between the two largest credit card networks, which means that they have not enjoyed the innovation that competition brings. For example, smart cards—cards that use a computer chip that will expand the ways consumers can make purchases—have been delayed for about a decade.43

The thinking seemed to be that if the French had smart cards, so should Americans. It turns out that the French cards are not all that smart, and they made sense there mainly because the French telephone system was so slow and expensive.44

To counter the paucity of evidence, the government's economic expert asserted that "it is important to recognize that record evidence of direct restraints on competition is likely to be only the tip of the iceberg."45 Of course this expert had no empirical basis for knowing whether he was looking at the tip of the giant iceberg or all of a little iceberg.46

CONCLUSION

There are several principles that should be addressed when considering consumer harm. First, we should be interested in long-run consumer welfare, so the courts should consider

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46 The court found against the government on the duality count. In particular, it rejected the innovation arguments of the government and its economic expert, noting that "plaintiff, through its expert Prof. Katz, has posited a theory as to how dual governance might create disincentives for some forms of competition between the associations, but has failed to offer credible evidence to support that theory." United States v. Visa U.S.A., Inc. 163 F. Supp. 2d 322, 378 (S.D.N.Y. 2001).
consumer harm in the future as well as in the past. Future consumer harm, however, is naturally more speculative than past consumer harm and should get less weight.

Second, we should be interested in overall consumer welfare. Therefore, if actions result in benefits and costs to consumers, both need to be weighed. It is not enough to show that some consumers are worse off—that is always true in competitive markets.

Third, we should recognize, with regard to proof requirements, that one size does not fit all. The kind of evidence that will be necessary to prove consumer harm will vary from case to case. Ultimately, the plaintiff should be required to prove that the actions at issue probably cause a reduction in consumer welfare through higher prices, lower output or lower quality. On the one hand, it is not enough to just claim that the action harms the competitive process even if that is supported by a Nobel Prize winning economist who has divined what the competitive process should be. On the other hand, it is not always necessary to conduct full-blown econometric studies of price and output effects to reach a reasoned conclusion.

Fourth, the courts should presume that markets work best when left to their own devices. If the court is to substitute its judgment for that of the market, it should bear the burden of proving that consumers would be better off. By placing competition policy in the hands of the courts rather than a regulatory authority, as a nation we have decided to give all business practices the benefit of the doubt. The great experiments conducted last century in having governments regulate or run some markets confirm how sensible this decision was.

Lastly, the courts themselves have a dismal record of substituting their judgment for the market. If we were to stack up all the writings the courts have made over the last century, those writings on how the courts have condemned business practices that help consumers would be far higher than the stack of those on how the courts have exonerated business practices that really do harm consumers. For example, anyone familiar with either the Chicago literature or the post-Chicago literature knows that there is no theoretical or empirical basis for a per se
rule against tying.\textsuperscript{47} Moreover there is no economic basis for believing that the application of the test described in the \textit{Jefferson Parish Hospital District No. 2 v. Hyde}\textsuperscript{48} decision will distinguish procompetitive from anticompetitive tying.\textsuperscript{49} The test cannot distinguish such tying because it does not consider overall consumer welfare.


\textsuperscript{49} See id. at 9–18.