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POLICY BRIEF

Conceptual Frameworks to Guide When to Replace Competition Law with Rules

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There is a movement afoot to shift oversight of conduct traditionally governed by antitrust law from ex post adjudication to ex ante regulation. In the U.S., this is epitomized by the Federal Trade Commission's (FTC's) proposal to adopt rules to govern commercial surveillance and data security and Congress's consideration of the American Innovation and Choice Online Act (AICOA). In Europe, it is reflected by the Digital Markets Act (DMA).

While it is tempting simply to dismiss these efforts as misguided, there are analytical frameworks that can inform when each approach to framing legal principles is most appropriate. This policy brief would like to assess the circumstances under which replacing case-by-case adjudication with a rule-based approach would make sense. It then applies those rubrics to the current move towards FTC rulemaking and the DMA.

I. The Relationship Between Rules and Adjudication

As an initial matter, we must confront whether ex post adjudication and ex ante regulation represent substitutes or complements. The former view frames the question as an either-or choice between these two regimes, which would make ex ante regulation and ex post adjudication mutu-

ally exclusive alternatives. The latter view envisions both approaches as coexisting simultaneously, which would make the choice between the two alternatives less stark.

A. The European view of antitrust and regulation as complements

When Europe began liberalizing markets, the expectation was that the emergence of competition would cause the need for sector-specific regulation to fall away and that thereafter competition law would govern any alleged misconduct.[1] This perspective has changed over the years toward one that envisions both regulation and competition law as coexisting indefinitely.[2] One prominent example is the European Court of Justice's price squeeze decisions, in which the court rejected arguments that the fact that presence of a comprehensive regulatory regime took the conduct outside the purview of competition law.[3]

B. The U.S. view of antitrust and regulation as substitutes

U.S. law has gone in the other direction. Historically, the existence of a comprehensive regulatory regime did not necessarily displace antitrust. The most prominent example is the landmark case that broke up AT&T, which was based in part on the failure of regulation.[4] At the same time, U.S. law developed doctrines such as primary jurisdiction and *Burford* abstention that postpone judicial action until regulators have completed their investigations into the same conduct.[5] The fact that these doctrines only postponed judicial action without displacing antitrust altogether meant they continued to regard the two regimes as complementary, although they did give primacy to regulation.

Other legal principles allow regulation to displace antitrust in its entirety rather than just postponing it as a matter of timing. One example is the provision contained in Section 5 of the Federal Trade Commission Act excluding certain highly regulated entities (such as common carriers) from the agency's authority to prevent unfair methods of competition.[6] Another prominent example is state action immunity announced in *Parker v. Brown*, although this doctrine was heavily influenced by principles of federalism.[7] More recently, the Supreme Court's decision in *Trinko* squarely invoked the presence of a regulatory regime as a primary reason for regarding certain conduct as falling outside antitrust.[8] The Supreme Court reaffirmed this conclusion five years later in *linkLine* when it relied on *Trinko* to hold that price squeezes do not represent a viable basis for a monopolization claim.[9]

These decisions clearly embraced the view that antitrust and regulation are substitutes. So stark was this determination that observers concluded that the breakup of AT&T would not have occurred had *Trinko* been the law during the 1980s.[10] Treating antitrust and regulation as alternative regimes promotes numerous policy rationales, including the avoidance of inconsistent judgments, the benefits of concentrating efforts into a single good adjudication, and the differences in

institutional competence that justify assigning responsibility to agencies over courts.[11] The facts of *Trinko* vividly illustrate these dynamics. In that case, the law firm asserting the antitrust claim had already sought and obtained relief from both the Federal Communications Commission and the New York Public Service Commission and remained free to do so again.[12] As a result, the Court concluded that antitrust liability would provide little additional benefit and would exceed the institutional competence of courts to oversee.[13]

II. Rationales for Preferring Regulation to Antitrust

To the extent that antitrust and regulation are properly regarded as substitutes, some basis must exist to choose between them. Two bodies of law provide conceptual frameworks to guide when to use each one. The first, familiar to everyone who follows antitrust law, are the principles that determine when to regard practices as illegal per se instead of applying the rule of reason. The second is the longstanding distinction between rules and standards.

A. Per se illegality vs. the rule of reason

One framework familiar to every antitrust lawyer is the distinction between per se illegality and rule of reason. The Supreme Court has recognized that the rule of reason, under which courts assess "all of the circumstances of a case," represents antitrust's default approach.[14] However, courts may declare restraints to be illegal per se when courts can predict with confidence that the restraint "would be invalidated in all or almost all instances under the rule of reason" because they "would always or almost always tend to restrict competition and decrease output," "have manifestly anticompetitive effects," and "lack . . . any redeeming virtue."[15] The Court has "expressed reluctance to adopt per se rules . . . where the economic impact of certain practices is not immediately obvious."[16] As a result, any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing" and is proper "only after courts have had considerable experience with the type of restraint at issue."[17]

B. Rules vs. standards

Another area of law that can inform whether law is better enforced through ex ante regulation or ex post adjudication is the longstanding debate between *rules* and *standards*. Rules specify in advance which factors will dictate a legal outcome, with a classic example being a speed limit of 55 miles per hour. Standards define an objective and allow decisionmakers to consider any circumstances relevant to that objective, such as exercising reasonable care when driving a vehicle.

The choice between rules and standards necessarily involves a tradeoff. Creating rules is costly and requires extensive knowledge of the conduct being regulated, but enforcing them is relatively

inexpensive, whereas standards are easy to draft but necessarily more difficult to apply.[18] The size of the aggregate benefits of the lower enforcement costs thus depend on the frequency with which they are applied.[19] The inherent incompleteness of any line-drawing exercise also necessarily means that all rules are over- and under-inclusive to some degree, whereas standards can more easily fit liability to the precise contours of the case at hand.[20] For example, the clear rule setting the voting age inevitably draws a line that arbitrarily excludes some 17 year olds who are effectively indistinguishable from many 18 year olds who are permitted to vote. Such problems are exacerbated when the conduct being regulated is more heterogeneous, which makes defining the rule more costly, or is undergoing more frequent economic or technological change, which requires the rule to be updated more frequently.[21]

C. Institutional competence

The choice between regulation and antitrust also turns to some degree on institutional competence. Courts lack specialized technical expertise, depend on the parties to present issues and evidence, restrict opportunities for public participation, and are poorly positioned to take implications for other aspects of the regulatory scheme into account.[22]

Again, the Supreme Court's *Trinko* decision provides useful guidance when it cautioned against assigning courts tasks that are "beyond the practical ability of a judicial tribunal to control."[23] Simply put, agencies are better situated to oversee remedies that require ongoing, day-to-day oversight.[24] Courts are particularly ill suited to tasks such as "identifying the proper price, quantity, and other terms of dealing,"[25] which must constantly adjust to shifts in consumer demand, entry and exit by competitors, and changes in factor costs and prices of substitute goods. The problems are illustrated nicely by the fact that ongoing disputes over price brought the landmark *Terminal Railroad* case to the Supreme Court on three separate occasions.[26]

III. Implications for FTC Rulemaking, AICOA, and the DMA

These insights provide a framework for assessing efforts to replace ex post case-by-case adjudication with ex ante regulation. The advisability of the FTC's advance notice of proposed rulemaking on commercial surveillance and data security depends on whether the agency has sufficient experience with these practices to conclude with confidence that the prohibited conduct almost always harm consumers. It also depends on whether the regulated conduct is sufficiently homogeneous and stable enough to make it amenable to rule-based approaches. The extent to which the remedies envision ongoing supervision would also favor rule-based approaches.

The conclusions with respect to the EU's DMA and the proposed AICOA are clearer. The theoretical economic literature clearly shows that the welfare implications of the type of vertical restraints addressed by AICOA and the DMA are ambiguous, and the empirical literature indicates

that these practices tend to be neutral or welfare enhancing in the vast majority of cases.[27] This is consistent with the last seventy years of Supreme Court precedent, which clearly indicates that vertical restraints are best governed by the ex post case-by-case approach associated with the rule of reason rather than by a return to the structuralist approach that was rejected in the 1960s and 1970s.[28]

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Notes

1. *See*, *e.g.*, Damien Geradin & Gregory Sidak, *European and American Approaches to Antitrust Remedies and the Institutional Design of Regulation in Telecommunications*, *in* 2 Handbook of Telecommunications Economics 518, 550 (Sumit K. Majumdar et al. eds., 2005).
2. *See*, *e.g.*, Richard M. Brunell, *In Regulators We Trust: The Supreme Court's New Approach to Implied Antitrust Immunity*, 78 Antitrust L.J. 279, 281-82 (2012).
3. Case COMP/38.784, Wanadoo España v. Telefónica, 2008 O.J. (C 83) 5 (summary of Commission decision), *aff'd sub nom.* Case T-398/07, Spain v. Comm'n, 2012 ECJ EUR-Lex LEXIS 231 (Mar. 29, 2012); *accord* Joaquín Almunia, Vice-President of the Eur. Comm'n Responsible for Compet. Pol'y, Remarks at the Center on Regulation in Europe (CERRE), *Competition v. Regulation: Where Do the Roles of Sector Specific and Competition Regulators Begin and End?* (Mar. 23, 2010), https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_10_121 ("[I]n the majority of cases competition instruments and regulatory instruments are actually complementary.").
4. Roger G. Noll & Bruce M. Owen, The Anticompetitive Uses of Regulation: United States v. AT&T, *in* The Antitrust Revolution 290, 300 (John E. Kwoka, Jr. & Lawrence J. White eds., 1989).
5. Daniel F. Spulber & Christopher S. Yoo, *Mandating Access to the Telecom and the Internet: The Hidden Side of Trinko*, 107 Colum. L. Rev. 1822, 1855-57 (2007).
6. 15 U.S.C. § 45(a)(2).
7. 317 U.S. 341 (1943).
8. Verizon Commc'ns Inv. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 411-13 (2004).
9. Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc., 555 U.S. 438 (2009).
10. Timothy Brennan, *Trinko v. Baxter: The Demise of* U.S. v. AT&T, 50 Antitrust Bull. 635 (2005).
11. Spulber & Yoo, *supra* note 5, at 1857-59.
12. *Trinko*, 540 U.S. at 413.
13. *Id*. at 412, 414-15.
14. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 885-86 (2007).
15. *Id*. at 886-87 (internal quotation marks and citations omitted).

16. *Id*. at 887 (internal quotation marks and citations omitted).

17. *Id*. at 886-87 (internal quotation marks and citations omitted).

18. Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. Legal Stud. 257, 266-67 (1974); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 570, 577 (1992).

19. Kaplow, *supra* note 19, at 563-64, 573, 577, 579-80.

20. Ehrlich & Posner, supra note 19, at 268-70. *But see* Kaplow, *supra* note 19, at 589 (arguing that standards may be more over- or under-inclusive than rules when the rules are more complex than the standards).

21. Ehrlich & Posner, *supra* note 19, at 270, 273, 277-78; Kaplow, *supra* note 19, at 600.

22. Spulber & Yoo, *supra* note 3, at 1863.

23. *Trinko*, 540 U.S. at 414 (internal quotation marks omitted).

24. *Id*. at 415.

25. *Id*. at 408.

26. Terminal R.R. Ass'n v. United States, 266 U.S. 17, 27 (1924); Terminal R.R. Ass'n v. United States, 236 U.S. 194, 195-96 (1915); *Ex parte* United States, 226 U.S. 420, 421 (1913); *see also* Abbott B. Lipsky, Jr. & J. Gregory Sidak, *Essential Facilities*, 51 Stan. L. Rev. 1187, 1196-98 (1999).

27. Christopher S. Yoo, *Technological Determinants and Its Discontents*, 929-31 (book review) (reviewing this literature).

28. Leegin; State Oil; Sylvania.