Journal of Antitrust Enforcement, Vol. 1, No. 1 (2013), pp. 162–197
doi:10.1093/jaenfo/jns008
Published on Advance Access February 4, 2013

Is competition always good?

Maurice E. Stucke*

Competition is the backbone of US economic policy. Competition advocacy is also thriving internationally. Promoting competition is broadly accepted as the best available tool for promoting consumer well-being. Competition officials, who regularly try to protect the public from anticompetitive special interest legislation, are justifiably jaded about complaints of excess competition. Although the economic crisis has prompted some policymakers to reconsider basic assumptions, the virtues of competition are not among them. Nonetheless to effectively advocate competition, officials must understand when competition itself is the problem's cause, not its cure. Market competition, while harming some participants, often benefits society. But does competition always benefit society? This is antitrust's blind spot. After outlining the virtues of competition, and discussing some well-accepted exceptions to competition law, this article addresses four scenarios where competition yields suboptimal results.

JEL codes: K21, K20 and K42

Introduction

Americans love to compete. More Americans strongly agreed than any other surveyed country's residents that they like situations where they compete.[1] Praised in various contexts,[2] competition is the backbone of US economic policy. The US Supreme Court observed, 'The heart of our national economic

*Associate Professor, University of Tennessee College of Law; Senior Fellow, American Antitrust Institute. Email: mstucke@utk.edu. I wish to thank for their helpful comments the participants at Oxford University and George Washington University's Antitrust Enforcement Symposium and the Midwest Law and Economics Association's Annual Meeting, Luca Arnaudo, Caron Beaton-Wells, Kenneth Davidson, John Davies, Harry First, Franklin Fisher, Thomas Horton, Max Huffman, Christopher Leslie, Stephen Martin, Jochen Meulman, Anne-Lise Sibony, Randy Stutz, Henry Su, and Spencer Weber Waller. I also thank the University of Tennessee College of Law for the summer research grant.

[1] Flash Eurobarometer, Entrepreneurship in the EU and beyond, Flash EB Series #283 (May 2010) 11 [American respondents 'were more likely than EU citizens and Chinese respondents to say they were risk-takers and liked competition (77%-82%); in comparison, the proportions for EU citizens were 55%-65% and for Chinese respondents, 65%-69%'], 88 ['Respondents in the US most frequently agreed that they liked situations in which they competed with others (77%, in total, agreed and 41% "'strongly agreed") '].

[2] See, eg George S Patton ('Battle is the most magnificent competition in which a human being can indulge. It brings out all that is best; it removes all that is base.') <http://www.brainyquote.com/quotes/quotes/g/georgespa143694.html> accessed 7 January 2013.

policy long has been faith in the value of competition.'[3] The belief in competition is not only embodied in the antitrust laws. Every US executive agency, for example, is legally required to have an advocate for competition.[4]

Competition advocacy is thriving internationally.[5] The past 20 years witnessed more countries with antitrust laws and the birth and growth of the International Competition Network (ICN), an international organization of governmental competition authorities, with over 100 member countries.[6] Although different constituencies accept to different degrees the benefits of competition and competition policy, the strongest competition advocates, in an ICN survey, were among the academic community, consumer associations, media, and nongovernmental organizations.[7] 'Within OECD countries, competition is now broadly accepted as the best available mechanism for maximising the things that one can demand from an economic system in most circumstances.'[8]

Preserving competition is, of course, the central tenet of America's antitrust laws:

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conductive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.[9]

[3] *Standard Oil Co v FTC* 340 US 231, 248 (1951); see also Antitrust Modernization Commission, *Report and Recommendations* (April 2007) 2 <http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm> accessed 7 January 2013 ('free-market competition is, and has long been, the fundamental economic policy of the United States'); *Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures* (1979) 177 [hereinafter *1979 Antitrust Report*]; *The Attorney General's National Committee to Study the Antitrust Laws* (1955) 1 ('Most Americans have long recognized that opportunity for free market access and fostering of market rivalry are basic tenets of our faith in competition as a form of economic organization.') [hereinafter *1955 Antitrust Report*]; see also European Commission, *Competition, in Glossary of Terms Used in EU Competition Policy: Antitrust and Control of Concentrations* (July 2002) (describing '[f]air and undistorted competition' as 'a cornerstone of a market economy').

[4] The agency's advocate for competition for each procuring activity is responsible for, inter alia, 'challenging barriers to, and promoting full and open competition in, the procurement of property and services by the executive agency' and identifying 'opportunities and actions taken to achieve full and open competition in the procurement activities of the executive agency'. 41 USC s 1705.

[5] World Bank, *World Development Report 2002: Building Institutions for Markets* (2002) 133; Paul Crampton, Head, Outreach Unit, Competition Division, OECD, 'Competition and Efficiency as Organising Principles for All Economic and Regulatory Policymaking', Prepared for the First Meeting of the Latin American Competition Forum (7–8 April 2003) 2 (advocating 'competition and efficiency [as the] policy "glue" that links and binds all economic and regulatory decision-making into a coherent framework').

[6] China viewed, until the late 1970s, the term competition pejoratively as a 'capitalist monster.' Xiaoye Wang, 'The New Chinese Anti-Monopoly Law: A Survey of a Work in Progress' (2009) 54 Antitrust Bull 579, 580. Now China, Russia, and India have competition laws.

[7] International Competition Network, Advocacy and Competition Policy—Report prepared by the Advocacy Working Group, for the ICN's Conference Naples, Italy, 2002 (2002) xi.

[8] Crampton (n 3) 3.

[9] *N Pac Ry Co v US* 356 US 1, 4 (1958).

Competition officials regularly try to protect the public from anticompetitive special interest legislation.[10] They are justifiably jaded about complaints of excessive competition. As one court observed, 'Entertaining claims of excessive competition would undermine the functions of the antitrust laws.'[11] This is especially relevant in an economic crisis, when competition is an attractive target. A US Department of Justice (DOJ) official observed:

> These days, it is unlikely that well-counseled firms will explicitly argue that they need to be saved from 'ruinous' or 'cutthroat' competition. But, under one name or another, this idea is likely to resurface. For example, two merging firms may well argue that ongoing competition will leave them with insufficient profits to make valuable and necessary investments to serve consumers. This is effectively a version of the 'ruinous competition' argument that should be treated skeptically.[12]

Although the economic crisis has prompted some policymakers to reconsider basic assumptions, the virtues of competition are not among them.[13] Nonetheless to effectively advocate competition, officials must understand when competition itself is the cause, not the remedy, of the problem. Market competition, while harming some participants, often benefits society.[14] But does competition always benefit society? This is antitrust's blind spot.

One could argue that the problem is not economic competition per se, but poor regulatory controls. This is a valid point. Part of competition's appeal is that no consensus exists on its meaning.[15] Competition does not exist abstractly, but is influenced by the existing legal and informal institutions.[16]

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[10] Advocacy Working Group, Int'l Competition Network, 'Advocacy Toolkit Part I: Advocacy Process and Tools', presented at the 10th Annual Conference of the ICN, The Hague (May 2011) 5 <http://www.internationalcompetitionnetwork.org/working-groups/current/advocacy.aspx> accessed 7 January 2013 ('When they engage in competition advocacy, competition agencies may aim to [1] persuade other public authorities not to adopt unnecessarily anticompetitive measures and help them clearly to delineate the boundaries of economic regulation [2] increase awareness of the benefits of competition, and of the role competition law and policy can play in promoting and protecting welfare enhancing competition wherever possible, among economic agents, public authorities, the judicial system and the public at large.').

[11] *Stamatakis Indus, Inc v King* 965 F 2d 469, 471 (7th Cir 1992), citing Edward A Snyder and Thomas E Kauper, 'Misuse of the Antitrust Laws: The Competitor Plaintiff' (1991) 90 Mich L Rev 551.

[12] Carl Shapiro, Deputy Assistant Attorney General, US Dep't of Justice, Antitrust Div, Competition Policy in Distressed Industries, Remarks Prepared for ABA Antitrust Symposium: Competition as Public Policy (13 May 2009) 9, <http://www.justice.gov/atr/public/speeches/245857.htm> accessed 7 January 2013; see also Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, 'Competition Policy as a Pan-European Effort' (2 October 2012) SPEECH/12/672, <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/12/672> accessed 7 January 2013.

[13] Shapiro (ibid) 2: 'The current crisis provides no basis for wavering from this core principle, which has enjoyed bipartisan support since the Sherman Act was passed in 1890.'

[14] *Composite Marine Propellers, Inc v Van Der Woude* 962 F 2d 1263, 1268 (7th Cir 1992) ('Competition is ruthless, unprincipled, uncharitable, unforgiving-and a boon to society, Adam Smith reminds us, precisely because of these qualities that make it a bane to other producers.').

[15] Maurice E Stucke, 'What is Competition?' in Daniel Zimmer (ed), *The Goals Of Competition Law* (Edward Elgar Publishing 2012); Maurice E Stucke, 'Reconsidering Competition' (2011) 81 Mississippi LJ 107.

[16] Douglass C North, *Understanding the Process of Economic Change* (Princeton University Press 2005) 52; RH Coase, 'The Institutional Structure of Production' (1992) 82 Am Econ Rev 713, 717–18; FA Hayek in Bruce Caldwell (ed), *The Road to Serfdom: Text and Documents – The Definitive Edition* (University of Chicago Press 2007) 87: Competition 'depends, above all, on the existence of an appropriate legal system, a legal system designed both to preserve competition and to make sure it operates as beneficially as possible.'

A chicken–egg dilemma follows: Is the problem with competition itself or the legal and informal institutions that yielded this type of competition? One's view depends in part on one's ideological reference point—namely the belief of competition existing outside a regulatory framework, necessitating governmental intervention in the marketplace versus the belief that regulatory forces help create and define competition in the market, necessitating improvements to the legal framework.

This article identifies the problem as competition itself, since under most theories of competition, markets characterized with low entry barriers (and recent entry) should not be prone to the market failures described herein.[17] Whatever the theory (failure of competition or regulations), society is worse off as a result.

The section 'The virtues of competition' outlines the virtues of competition. The section 'Competition sacrificed' discusses some well-accepted exceptions to competition policy. The section 'The dark side of competition' addresses four scenarios where competition yields a suboptimal result.

The virtues of competition

Among competition's many virtues, the Supreme Court observed, are its being 'the best method of allocating resources in a free market' and 'that all elements of a bargain-quality, service, safety, and durability-and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers'.[18] Competition can yield:

- lower costs and prices for goods and services,
- better quality,

[17] High entry barriers, as John Davies illustrated to me with the example below, are also consistent with suboptimal competition. In most markets, one assumes that if a merger reduces choice in a way that damages consumer welfare, that creates an opportunity for a choice-restoring entrant. However, at times, the degree of choice does not evolve in a market, but is imposed. Suppose there are two types of grocery chains–high quality/high price gourmet supermarkets and every-day-low-price/low-service supermarkets. Suppose a town has two supermarkets: A (gourmet) and B (discounter). Suppose C (a chain of discount supermarkets) buys Chain A, and finds it more profitable to change A's product offering to C's private label in all the Chain A supermarkets. Now the town has two deep-discount supermarkets: Chains B and C. In some countries, like the UK, the available space (under the land planning system) for supermarkets is limited. Entry will not correct the local worsening of the choice available to consumers, and reduction in aggregate consumer welfare. A competition agency, however, would unlikely challenge the supermarket merger, as competition will likely increase, not decrease, post-merger. Indeed, instead of the weak competition between the highly differentiated high-end Supermarket A and low-end offerings of Supermarket B, the town now enjoys head-to-head competition in the same discount segment. But there is a loss of choice. Some consumers preferred A's high-end offering. Many—probably most—will have shopped at both stores, for different items. All of those people have lost some welfare. As Davies observed, this scenario may be unique to industries like retail chain mergers, when the new owners change the products on sale immediately to match its house brands, which may not hold true of other types of goods and services. But Davies raises an interesting example where competition increases but consumer welfare decreases. Another example is competition among producers of harmful goods. See, eg Daniel A Crane, 'Harmful Output in the Antitrust Domain: Lessons from the Tobacco Industry' (2005) 39 Ga L Rev 321, 409.

[18] *Nat'l Soc of Prof'l Engineers v US* 435 US 679, 695 (1978).

- more choices and variety,
- more innovation,
- greater efficiency and productivity,
- economic development and growth,
- greater wealth equality,
- a stronger democracy by dispersing economic power, and
- greater wellbeing by promoting individual initiative, liberty, and free association.[19]

Competition's virtues are so ingrained within the antitrust community that competition often takes a religious quality. The Ordoliberal, Austrian, Chicago, post-Chicago, Harvard, and Populist schools, for example, can disagree over how competition plays outs in markets, the proper antitrust goals, and the legal standards to effectuate the goals. But they unabashedly agree that competition itself is good. Antitrust policies and enforcement priorities can change with incoming administrations. But the DOJ and US Federal Trade Commission (FTC) steadfastly target horizontal restraints and erection of entry barriers via legislation.[20] Competition authorities from around the world may disagree over substantive and procedural issues, but they all advocate competition.[21] Indeed the labels 'pro-competitive' and 'anticompetitive' are synonymous with socially beneficial and detrimental conduct.

Some policies that ostensibly restrict competition are justified for promoting competition. Intellectual property rights, for example, can restrict competition along some dimensions (such as the use of a trade name). But the belief is that intellectual property and antitrust policies, rather than conflict, complement one another in promoting innovation and competition.[22] Likewise,

[19] AMC Report (n 3) 2–3; World Bank (n 5) 133; David J Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (OUP 1998) 242–45; *1979 Antitrust Report* (n 3) 178–79; *1955 Antitrust Report* (n 3) 1–2, 317–18; William J Kolasky, Deputy Assistant Attorney General, US Dep't of Justice, Antitrust Div, 'The Role of Competition in Promoting Dynamic Markets and Economic Growth' (12 November 2002), 2002 WL 34170825 (DOJ) ('The competition for capital and other resources by firms throughout the economy leads to money and resources flowing away from weak, uncompetitive sectors and firms and towards the strongest, most competitive sectors, and to the strongest and most competitive firms within those sectors. In these ways, the very operation of the competitive process makes decisions on restructuring clear, and leads to the strongest and most competitive economy possible.').

[20] James C Cooper and others, 'Theory and Practice of Competition Advocacy at the FTC' (2005) 72 Antitrust LJ 1091, 1093 n6 (charting the shifts in FTC advocacy filings between 1980 and 2004).

[21] Advocacy Working Group, Int'l Competition Network, 'Advocacy and Competition Policy Report' (2002) 25 <http://www.internationalcompetitionnetwork.org/uploads/library/doc358.pdf> accessed 7 January 2013 ('Competition advocacy refers to those activities conducted by the competition authority related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms, mainly through its relationship with other governmental entities and by increasing public awareness of the benefits of competition').

[22] US Dep't of Justice & Fed. Trade Comm'n, 'Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition' (2007) 1, 2, <www.justice.gov/atr/public/hearings/ip/222655.htm> accessed 7 January 2013 ('intellectual property law's grant of exclusivity was seen as creating monopolies that were in tension with antitrust law's attack on monopoly power. Such generalizations are relegated to the past. Modern understanding of these two disciplines is that intellectual property and antitrust laws work

contractual non-compete clauses are justified for their pro-competitive benefits.[23]

Given their faith in competition's healing powers, antitrust officials and courts typically distrust complaints about competition.[24] They are rightfully wary when industry groups or other government agencies decry competition as ruinous or destructive. First, consumers can pay more for poorer quality products or services, and have fewer choices. Second, governmental or private restraints can raise exit costs and inhibit innovation. Third, economic regulation can attract special interest groups to lobby for regulations that benefit them to society's detriment. Competitors, challenged by new rivals or new forms of competition, may turn to regulators for help. Competitors may ask governmental agencies under the guise of consumer protection to prohibit or restrict certain pro-competitive activity, such as discounts to their clients. They may enlist the government to increase trade barriers or for other protectionist measures. Such 'rent-seeking' behavior benefits lobbyists and lawyers, but can substantially waste scarce resources. Finally, impeding competition can cause significant anti-democratic outcomes, like concentrated economic and political power, political instability, and corruption.[25]

Accordingly, antitrust officials are justly suspicious when regulatory bodies decide that a company's entry would 'tend to a destructive competition in markets already adequately served and would not be in the public interest'.[26] Such decisions are best left to consumers, not regulators.

in tandem to bring new and better technologies, products, and services to consumers at lower prices. . . . Both spur competition among rivals to be the first to enter the marketplace with a desirable technology, product, or service.'); Christopher R Leslie, 'Antitrust and Patent Law as Component Parts of Innovation Policy' (2009) 34 J Corp Law 1259 (discussing how antitrust and IP law are 'neither always in tension nor always complementary' but intertwined components of an overall innovation policy that maximizes both static and dynamic competition).

[23] *Lektro-Vend Corp v Vendo Co* 660 F 2d 255, 265 (7th Cir 1981) ('The recognized benefits of reasonably enforced noncompetition covenants are by now beyond question.'); *US v Addyston Pipe & Steel Co* 85 F 271, 281-82 (6th Cir 1898), aff'd as modified, 175 US 211 (1899).

[24] See, eg *US v Socony-Vacuum Oil Co* 310 US 150, 220–21 (1940) ('Ruinous competition, financial disaster, evils of price cutting and the like appear throughout our history as ostensible justifications for price-fixing.'); *Addyston Pipe & Steel*, 175 US at 213–14 (defendants defending their bid rigging 'for the purpose of avoiding the great losses they would otherwise sustain, due to ruinous competition'). But in *Appalachian Coals, Inc v United States*, the Court held that the competitors' proposed price-fixing did not violate the Sherman Act if the horizontal restraints were not detrimental to the Court's conception of 'fair competition'. 288 US 344, 373 (1933). The coal producers were confronted with the oversupply of coal, exacerbated in part by certain 'destructive' trade practices, such as buyers dumping 'distressed' coal (due in part to lack of storage facilities) onto the market. In response to industry conditions, coal producers proposed an exclusive selling agent to enable the former competing producers to fix the coal prices.

[25] Daron Acemoglu and James A Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (Crown Business 2012) 3–4; World Bank (n 5) 135.

[26] *Farmland Dairies v Comm'r of New York State Dept of Agric & Markets* 650 F Supp 939, 943 (EDNY 1987) [quoting Commissioner's Determination, State of New York Department of Agriculture and Markets 21 (11 December 1986)].

Competition sacrificed

As the previous section discusses, competition, given its virtues, is the backbone of US economic policy. But competition, while often praised, is also criticized.[27] One economic reality, as this section outlines, is that competition and antitrust law do not permeate all social and economic activity.

Activity not subject to competition

Life would be more stressful if we competed for everything. Competition cannot always be preferred over cooperation. Cooperation is often more appealing and socially rewarding.[28] Society and competitors at times benefit when rivals cooperate in joint ventures and addressing societal needs (such as supporting education for specific trades). The divide between cooperation and competition is beyond this article's scope.[29] But one important issue is when competition makes people less cooperative, promotes selfishness and free-riding, reduces contributions to public goods, and leaves society worse off.[30]

Social and religious norms exclude or curtail competition in many daily settings. Commuting to work, in theory, is not a competitive sport. Parents should not foster competition among their children for their affection.[31] None of the pleasurable daily or weekly activities (ie intimate relations, socializing after work, relaxing, dinner, lunch, praying/worship) necessarily implicate competition.[32] Parishioners are discouraged from competing for better pews and parking spaces. Nor do the mainstream religions endorse a deity who wants people to compete for His love.

[27] See, eg *Blankenship v Lewis County Fiscal Court* Civ Act No 06-147-EBA, 2007 WL 4404165 (ED Ky 17 December 2007) (county government denying plaintiff permit to collect and haul away residents' waste 'on the grounds that permitting additional waste hauling businesses to operate in Lewis County would create too much competition for the existing seven businesses providing that service to the community').

[28] Jean Decety and others, 'The Neural Bases of Cooperation and Competition: an fMRI Investigation' (2004) 23 NeuroImage 744, 749 (finding that while cooperation and competition activated the frontoparietal network and anterior insula, 'distinct regions were found to be selectively associated with cooperation and competition, notably the orbitofrontal cortex in the former and the inferior parietal and medial prefrontal cortices in the latter.').

[29] Saul Levmore, 'Competition and Cooperation' (1998) 97 Michigan L Rev 216.

[30] Stefania Ottone and Ferruccio Ponzano, 'Competition and Cooperation in Markets: The Experimental Case of a Winner-take-all Setting' (2010) 39 J of Socio-Economics 163, 169–70 (finding that in winner-take-all scenario where subjects with homogeneous skills meet more than once stimulates greater cooperation than subjects in a perfect competition scenario); Claudia Canegallo and others, 'Competition Versus Cooperation: Some Experimental Evidence' (2008) 37 J of Socio-Economics 18, 24–25 (finding 'the presence and the degree of competition in the economic environment significantly affect the willingness of individuals to cooperate, in a negative relation').

[31] The American Academy of Pediatrics, *Caring for Your School-Age Child: Ages 5 to 12* (Bantam 1999) 367–72.

[32] Daniel Kahneman and Alan B Krueger, 'Development in the Measurement of Subjective Well-Being' (2006) 20 J of Economic Perspectives 3, 13.

Antitrust norms do not translate easily in these social or religious settings. For example, if private companies agree to not cold call each other's employees for employment opportunities, they face antitrust liability.[33] Some religions arguably compete for new members.[34] But it is doubtful that religious leaders are liable for agreeing not to proselytize each other's members and to share information to enforce such agreements.[35]

Some goods and services are not subject to market competition.[36] Although a market may otherwise form between willing buyers and sellers, the country's laws and informal norms prevent these markets' formation or curtail the economic competition therein. One example is human organs. Among the concerns economist Alvin Roth identifies are (i) 'objectification'—pricing a thing or service moves it into a class of impersonal objects to which it does not belong [eg payment for organs transforms a good deed (donating one's organs) into a bad one (marketing and selling one's organs that violates human dignity)]; (ii) 'coercion'—giving money 'might leave some people, particularly the poor, open to exploitation from which they deserve protection'; and (iii) the 'slippery slope'—monetizing transactions 'may cause society to slide down a slippery slope to genuinely repugnant transactions' [eg lenders use organs as collateral for debts, and opens up sale of body parts generally (including eyes, arms, legs, etc.)].[37]

This is not fixed. Markets once considered repugnant (eg lending money for interest, life insurance for adults) are no longer. Markets that are repugnant today (eg slavery), once were not.

[33] *Compl, US v Adobe Systems, Inc*, Civ Act No 1:10-cv-01629 (DDC filed 24 September 2010) <http://www.justice.gov/atr/cases/f262600/262650.htm> accessed 7 January 2013.

[34] Daniel M Hungerman, 'Rethinking the Study of Religious Markets' in Rachel McCleary (ed), *The Oxford Handbook of the Economics of Religion* (OUP 2010) 257–75.

[35] Joint International Commission for the Theological Dialogue between the Roman Catholic Church and the Orthodox Church VIIth Plenary Session, Balamand School of Theology (Lebanon) (17–24 June 1993) <http://www.vatican.va/roman_curia/pontifical_councils/chrstuni/ch_orthodox_docs/rc_pc_chrstuni_doc_19930624_lebanon_en.html> accessed 7 January 2013 ('Pastoral activity in the Catholic Church, Latin as well as Oriental, no longer aims at having the faithful of one Church pass over to the other; that is to say, it no longer aims at proselytizing among the Orthodox. It aims at answering the spiritual needs of its own faithful and it has no desire for expansion at the expense of the Orthodox Church. Within these perspectives, so that there will be no longer place for mistrust and suspicion, it is necessary that there be reciprocal exchanges of information about various pastoral projects and that thus cooperation between bishops and all those with responsibilities in our Churches, can be set in motion and develop.'), but see Barak D Richman, 'Saving the First Amendment from Itself: Relief from the Sherman Act Against the Rabbinic Cartels' (21 April 2012) Pepperdine L Rev, Forthcoming <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1808005> accessed 7 January 2013 (discussing antitrust challenge of the Conservative Judaism movement's rules governing the rabbi hiring process).

[36] Alvin E Roth, 'Repugnance as a Constraint on Markets' (2007) 21 J of Economic Perspectives 37–58; Michael J Sandel, 'What Isn't for Sale' *The Atlantic* (April 2002) <http://www.theatlantic.com/magazine/archive/2012/04/what-isnt-for-sale/308902/> accessed 7 January 2013.

[37] Roth (ibid) 44–45; Dan Bilefsky, 'European Crisis Bolsters Illegal Sales of Body Parts' *NY Times* (1 June 2012) <http://www.nytimes.com/2012/06/01/world/europe/european-crisis-bolsters-illegal-sales-of-body--parts.html?pagewanted=all&_r=0> accessed 7 January 2013; French Civil Code Art 16-1 ('Everyone has the right to respect for his body. The human body is inviolable. The human body, its elements and its products may not form the subject of a patrimonial right.') and Art 16-5 ('Agreements that have the effect of bestowing a patrimonial value to the human body, its elements or products are void.').

Antitrust immunities

The US antitrust laws apply across most industries and to nearly all forms of business organizations. But the Court noted:

> Surely it cannot be said . . . that competition is of itself a national policy. To do so would disregard not only those areas of economic activity so long committed to government monopoly as no longer to be thought open to competition, such as the post office, cf., e.g., 17 Stat. 292 (criminal offense to establish unauthorized post office; provision since superseded), and those areas, loosely spoken of as natural monopolies or-more broadly-public utilities, in which active regulation has been found necessary to compensate for the inability of competition to provide adequate regulation. It would most strikingly disregard areas where policy has shifted from one of prohibiting restraints on competition to one of providing relief from the rigors of competition, as has been true of railroads.[38]

Some or all economic activity in various industries is expressly immunized from antitrust liability.[39] Other significant areas of the economy are subject to implied antitrust immunity. The Court's state action doctrine, for example, reflects the realities of state and local governments' displacing competition for other aims.[40]

Noncommercial activities intended to promote social causes

Economic activity, even if not immunized, may fall outside the scope of the antitrust law. Although Congress intended the Sherman Act to apply to commercial activity, its legislative history 'reveals that it was not intended to reach noncommercial activities that are intended to promote social causes'.[41] Senator John Sherman did not oppose one proposed change to his bill that would exclude temperance organizations seeking to enforce state laws that discourage the use of liquor. But Sherman did not see:

> any reason for putting in temperance societies any more than churches or school-houses or any other kind of moral or educational associations that may be

[38] *FCC v RCA Communications* 346 US 86, 92 (1953).

[39] Maurice E Stucke and Allen P Grunes, 'Why More Antitrust Immunity for the Media is a Bad Idea' (2011) 105 Northwestern U L Rev 1399, 1401–2 (citing US statutory antitrust exemptions for newspapers, agriculture, export activities, insurance, labor, fishing, defense preparedness, professional sports, small business joint ventures, and local governments).

[40] *City of Lafayette, La v Louisiana Power & Light Co* 435 US 389, 413 (1978) ('*Parker* doctrine exempts only anticompetitive conduct engaged in as an act of government by the State as sovereign, or, by its subdivisions, pursuant to state policy to displace competition with regulation or monopoly public service.'); State Corporation Commission, Commonwealth of Virginia, Application of Beneficial Finance Corp, Case No 20095 (24 August 1979), 1979 SCC Ann Rept 399 (Va Corp Com), 1979 WL 4763 (Va Corp Com) 4 (noting how Virginia amended its small loan licensing statute with a 'convenience and advantage' clause to limit entry 'so that the aims of the state's small loan acts might not be subverted by the supposed harmful consequences of having too many lenders and too much competition.').

[41] *Hamilton Chapter of Alpha Delta Phi, Inc v Hamilton College* 128 F 3d 59, 63 (2nd Cir 1997).

organized. Such an association is not in any sense a combination arrangement made to interfere with interstate commerce.[42]

Thus, the Sherman Act's 'trade or commerce' element applies to transactions one can characterize as 'business' or 'commercial'.[43] Several courts have held that if universities agree on the eligibility criteria for their student athletes, their eligibility rules are not subject to antitrust scrutiny.[44] Rather than intending to provide the universities with a commercial advantage, these rules governing recruiting, improper inducements, and academic fraud primarily seek 'to ensure fair competition in intercollegiate athletics'.[45]

Unfair methods of competition

Courts routinely reject the defense that every method of competing, such as passing one's goods off the brand of another, benefits society.[46] Although competition is beneficial, not all forms of competition are beneficial. Just as athletic contests distinguish between fair and foul play, the law distinguishes between fair and unfair methods of competition.[47] This legislative policy

[42] 21 Cong Rec 2658–59 (1890); see also Harry First, 'Private Interest and Public Control: Government Action, The First Amendment, and the Sherman Act' (1975) 1975 Utah L Rev 9, 13 n38; *State of Mo v Nat'l Org for Women, Inc* 620 F2d 1301, 1309 (8th Cir 1980) ('it was the competitors in commerce that Senator Sherman had in mind as the concern of his bill, not noncompetitors motivated socially or politically in connection with legislation').

[43] See, eg *Bassett v NCAA* No 06-5795, 2008 US App LEXIS 12248, 2008 WL 2329755 (6th Cir 9 June 2008); *United States v Brown Univ* 5 F 3d 658, 665 (3d Cir 1993) (finding it 'axiomatic that section one of the Sherman Act regulates only transactions that are commercial in nature'); *Donnelly v Boston Coll* 558 F2d 634, 635 (1st Cir 1977) (defendants' law school activities do not have 'commercial objectives').

[44] See, eg *Smith v NCAA* 139 F 3d 180, 185 (3rd Cir 1998). Smith also included a Title IX claim, which the Third Circuit allowed to proceed. Smith sought certiorari to review the dismissal of her Sherman Act claim, and the NCAA sought certiorari to review the Third Circuit's treatment of the Title IX claim. The Supreme Court granted certiorari and reversed the Third Circuit's analysis under Title IX. *NCAA v Smith* 525 US 459 (1999). However, the Court denied certiorari on the Sherman Act claim, allowing that decision by the Third Circuit to stand. ibid 464 n2.

[45] *Bassett v NCAA* 528 F 3d 426, 433 (6th Cir 2008) [quoting *Smith v NCAA* 139 F 3d 180, 185 (3rd Cir 1998)]. Other courts, however, have applied the Sherman Act to regulations designed to preserve amateurism and fair competition in university athletics, but upheld them under the rule of reason. See, eg *Justice v Nat'l Collegiate Athletic Ass'n* 577 F Supp 356, 382 (D Ariz 1983).

[46] *Boehringer Ingelheim GmbH v Pharmadyne Laboratories* 532 F Supp 1040, 1066-67 (DNJ 1980) (footnotes omitted):

> In trying to drape themselves in the mantle of free competition, defendants are disingenuous. Their decision to simulate plaintiffs' trade dress yields society no benefits. . . . Above-board competition directed at factors such as quality and price is in society's interests. Obtaining sales by facilitating passing off is not. The effect of defendants' copying of [Plaintiffs' trade dress] is that sales earned by plaintiffs through hard work are lost to pharmacist greed. The Lanham Act and New Jersey common law embody society's belief that that form of 'competition' is socially undesirable, and may be restrained.

[47] See, eg Federal Trade Commission Act s 5, as amended, 15 USCA s 45; *TianRui Group Co Ltd v Int'l Trade Comm'n* 661 F 3d 1322, 1323–24 (Fed Cir 2011) (concluding that the International Trade Commission has statutory authority to investigate and grant relief based in part on extraterritorial conduct insofar as it is necessary to protect domestic industries from injuries arising out of unfair competition in the domestic marketplace); Dee Pridgen and Richard M Alderman, *Consumer Protection and the Law* (West 2011) vol 1; Hazel Carty, *An Analysis of the Economic Torts* (OUP 2001); Tony Weir, *Economic Torts* (OUP 1997) 3 ('the requirement that the means (as opposed to the end) be wrongful (as opposed to generally deplorable) is entirely correct, sensible and practical').

recognizes that some methods of competition are socially undesirable. As one treatise observed:

> on ethical, religious and social sources, American law has developed a minimum level or standard of 'fairness' in competitive rivalry. The law of unfair competition has developed as a kind of Marquis of Queensbury code for competitive infighting. To pursue the analogy, it would be equally as unacceptable for the contestants in a prize-fight to agree privately to 'throw the fight' as it would be for one contestant to insert a horseshoe in his glove.[48]

★ ★ ★

In reviewing the section 'Competition sacrificed', the antitrust community would not quibble about eliminating or limiting competition in noncommercial activities. The antitrust community would debate over what constitutes fair and unfair methods of competition, but agree that not all methods of competition are desirable. The community would likely tolerate price and service regulations in some industries (eg natural monopolies) where competition is not feasible.[49] As for antitrust immunities, the consensus within the antitrust community is that they reflect the victory of special interest groups and the collective action problem of citizens.[50] Antitrust immunity is rarely a good thing, is rarely justifiable on the grounds of improving societal wellbeing, often outlives its intended purpose, and should be read 'narrowly, with beady eyes and green eyeshades'.[51]

For most other commercial activity, however, competition on the merits is the presumed policy. As one American court observed:

> The Sherman Act, embodying as it does a preference for competition, has been since its enactment almost an economic constitution for our complex national economy. A fair approach in the accommodation between the seemingly disparate goals of regulation and competition should be to assume that competition, and thus antitrust law, does operate unless clearly displaced.[52]

Few, if any, antitrust practitioners would disagree.

[48] *McCarthy on Trademarks and Unfair Competition* (4th edn, West 2012) vol 1, s 1:23.

[49] See, eg *Lancaster Cmty Hosp v Antelope Valley Hosp Dist* 940 F 2d 397, 402 n9 (9th Cir 1991) ('This court, in considering whether a state has intended to displace competition with regulation, seems to have considered whether competition is generally thought to be a viable alternative to regulation in the relevant sphere of economic activity. In cases involving paradigmatic natural monopolies, we have more readily found that the legislature has intended to displace competition with regulation.'); *Almeda Mall, Inc v Houston Lighting & Power Co* 615 F 2d 343, 355 (5th Cir 1980) ('These industries are regulated precisely because it has been determined that competition either cannot or should not prevail there. Thus, the regulatory scheme not only seeks to act as a surrogate for competition, but may, for public interest reasons, affirmatively seek to exclude competition from the marketplace.') [quoting Watson and Brunner, 'Monopolization by Regulated 'Monopolies': The Search for Substantive Standards' (1977) 22 Antitrust Bull 559, 566–69].

[50] James C Cooper and William E Kovacic, 'U.S. Convergence with International Competition Norms: Antitrust Law and Public Restraints on Competition' (2010) 90 BU L Rev 1555, 1582.

[51] *Chi Prof'l Sports Ltd. P'ship v Nat'l Basketball Ass'n* 961 F 2d 667, 671–72 (7th Cir 1992); Stucke and Grunes (n 39) 1401–4.

[52] *Essential Communications Sys, Inc v Am Tel & Tel Co* 610 F 2d 1114, 1117 (3d Cir 1979).

The dark side of competition

In condemning private and public anti-competitive restraints, competition officials and courts invariably prescribe competition as the cure. Increasing competition 'improves a country's performance, opens business opportunities to its citizens and reduces the cost of goods and services throughout the economy'.[53] Competition, officials recognize, does not cure every market failure (such as from negative externalities or public goods).[54] Fierce competition ultimately may yield oligopolies or monopolies. But that is a function of market conditions, not competition itself. Competition itself cannot cause market failures.

Although competition is often beneficial, is competition 'always' beneficial? Economist Irving Fisher over a century ago examined two assumptions of any laissez-faire doctrine:

> first, each individual is the best judge of what subserves his own interest, and the motive of self-interest leads him to secure the maximum of well-being for himself; and, secondly, since society is merely the sum of individuals, the effort of each to secure the maximum of well-being for himself has as its necessary effect to secure thereby also the maximum of well-being for society as a whole.[55]

In relaxing these two assumptions, Fisher discussed how competition is not always beneficial. In the past decade, the economic literature has identified several scenarios where the problem is not too little competition, or concerns over unfair methods of competition, but the suboptimal effects from competition itself.

Using the recent advances in behavioral economics, subsections 'Behavioral exploitation' and 'Competitive escalation paradigm' examine Fisher's first assumption. Surveying some recent empirical economic work, subsections 'When individual and group interests diverge' and 'When competition among intermediaries reduces accuracy' examine Fisher's second assumption.

Behavioral exploitation

Competition policy typically assumes that market participants can best judge what subserves their interests.[56] Once we relax the assumption of market participants' rationality and willpower, then competition at times leaves consumers and society worse off. Suboptimal competition can arise when

[53] OECD, 'Competition Assessment Toolkit version 2.0, Principles' (2011) 3.
[54] Shapiro (n 12) ('In terms of the classic categories of market failure from the Fundamental Theorem of Welfare Economics, most regulations – including environmental regulations, health and safety regulations, and consumer protection regulations – primarily address problems of externalities, public goods, and imperfect information. Competition policy primarily addresses the problem of market power.').
[55] Irving Fisher, 'Why Has the Doctrine of Laissez Faire Been Abandoned?' *Science* (4 January 1907) 19.
[56] Amanda P Reeves and Maurice E Stucke, 'Behavioral Antitrust' (2011) 86 Indiana LJ 1527, 1545–53.

firms compete in fostering and exploiting demand-driven biases or imperfect willpower.

To illustrate, suppose many consumers share certain biases and limited willpower. Competition benefits society when firms compete to help consumers obtain or find solutions for their bounded rationality and willpower. Alternatively, competition harms society when firms compete to better exploit consumers' bounded rationality or willpower. Suboptimal competition is unlikely if firms inform bounded rational consumers of other firms' attempts to exploit them. Providing this information is another facet of competition—trust us, we will not exploit you.[57] This is not always true.[58] Rather than compete to build consumers' trust in their business, firms instead compete in devising better or new ways to exploit consumers, such as:

- using framing effects and changing the reference point, such that the price change is viewed as a discount, rather than a surcharge;[59]
- anchoring consumers to an artificially high suggested retail price, from which bounded rational consumers negotiate;[60]
- adding decoy options (such as restaurant's adding higher priced wine) to steer consumers to higher margin goods and services;[61]

[57] See *SCFC ILC, Inc v Visa USA, Inc* 36 F 3d 958, 965 (10th Cir 1994) {'If the structure of the market is such that there is little potential for consumers to be harmed, we need not be especially concerned with how firms behave because the presence of effective competition will provide a powerful antidote to any effort to exploit consumers.' [quoting George A Hay, 'Market Power in Antitrust' (1992) 60 Antitrust LJ 807, 808]}.

[58] See, eg *Eastman Kodak Co v Image Technical Servs, Inc* 504 US 451, 474 n21 (1992) (noting that 'in an equipment market with relatively few sellers, competitors may find it more profitable to adopt Kodak's service and parts policy than to inform the consumers'); *FTC v RF Keppel & Bro, Inc* 291 US 304, 308, 313 (1934) (finding that while competitors 'reluctantly yielded' to the challenged practice to avoid loss of trade to their competitors, a 'trader may not, by pursuing a dishonest practice, force his competitors to choose between its adoption or the loss of their trade'); *Ford Motor Co v FTC* 120 F 2d 175, 179 (6th Cir 1941) (Ford following industry leader General Motors in advertising a deceptive 6 per cent financing plan); Matthew Bennett and others, 'What Does Behavioral Economics Mean for Competition Policy?' (2010) 6 Competition Pol'y Int'l 111, 118; Eliana Garcés-Tolon, 'The Impact of Behavioral Economics on Consumer and Competition Policies' (2010) 6 Competition Pol'y Int'l 145, 150; Max Huffman, 'Marrying Neo-Chicago with Behavioral Antitrust' (2012) 78 Antitrust LJ 105, 134 ('consciously parallel behavioral exploitation is the nearly industry-wide policy of unbundling charges for checked bags in airline travel').

[59] Steffen Huck and others, 'Consumer Behavioural Biases in Competition: A Survey, Final Report for the OFT' (May 2011) para 2.5 [hereinafter OFT Report], <www.oft.gov.uk/shared_oft/research/OFT1324.pdf> accessed 7 January 2013.

[60] In one experiment, MBA students put down the last two digits of their social security number (SSN) (eg 14). Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (HarperCollins 2008) 25–28. The students, then participants, monetized it (eg $14), and then answered for each bidded item 'Yes or No' if they would pay that amount for the item. The students then stated the maximum amount they were willing to pay for each auctioned product. Students with the highest ending SSN (80–99) bid 216 to 346 per cent higher than students with low-end SSNs (1–20), who bid the lowest; see also Daniel Kahneman, *Thinking, Fast and Slow* (Farrar, Straus and Giroux 2011) 119–28 (discussing anchoring effects generally).

[61] Similarly, people 'rarely choose things in absolute terms', but instead based on their relative advantage to other things. Ariely (ibid) 2–6. By adding a third more expensive choice, for example, the marketer can steer consumers to a more expensive second choice. MIT students, in one experiment, were offered three choices for the *Economist* magazine: (i) Internet-only subscription for $59 (16 students); (ii) print-only subscriptions for $125 (no students); and (iii) print-and-Internet subscriptions for $125 (84 students). When the 'decoy' second choice (print-only subscriptions) was removed and only the first and third options were presented, the students did not react similarly. Instead 68 students opted for Internet-only subscriptions for $59 (up from 16 students) and only 32 students chose print-and-Internet subscriptions for $125 (down from 84 students).

- using the sunk cost fallacy to remind consumers of the financial commitment they already made to induce them to continue paying installments on items, whose value is less than the remainder of payments;
- using the availability heuristic[62] to drive purchases, such as an airline travel insurer using an emotionally salient death (from 'terrorist acts') rather than a death from 'all possible causes';[63]
- using the focusing illusion in advertisements (ie consumers predicting greater personal happiness from consumption of the advertised good and not accounting one's adaptation to the new product);[64] and
- giving the impression that their goods and services are of better quality because they are higher priced[65] or based on one advertised dimension.[66]

The credit card industry provides one example. Some consumers do not understand the complex, opaque ways late fees and interest rates are calculated, and are overoptimistic on their ability and willpower to timely pay off the credit card purchases.[67] They underestimate the costs of their future borrowings and overestimate their likelihood of switching to lower interest credit.[68] The consumers choose credit cards with lower annual fees (but higher financing fees and penalties) over better-suited products (eg credit cards with higher annual fees but lower interest rates and late payment penalties).[69]

Rational companies can exploit consumers' biases.[70] One former CEO, for example, explained how his credit card company targeted low-income customers 'by offering "free" credit cards that carried heavy hidden fees'.[71]

[62] Amos Tversky and Daniel Kahneman, 'Judgment Under Uncertainty: Heuristics and Biases' *Science* (27 September 1974) 1127 (noting situations where people assess the 'frequency of a class or the probability of an event by the ease with which instances or occurrences can be brought to mind').

[63] See generally Eric J Johnson and others, 'Framing, Probability Distortions, and Insurance Decisions' (1993) 7 J Risk & Uncertainty 35.

[64] Kahneman (n 60) 402–7.

[65] Ariely conducted several experiments that revealed the power of higher prices. Ariely (n 60) 181–86. In one experiment, nearly all the participants reported less pain after taking a placebo priced at $2.50 per dose; when the placebo was discounted to $0.10 per dose, only half of the participants experienced less pain. Similarly, MIT students who paid regular price for the 'SoBe Adrenaline Rush' beverage reported less fatigue than the students who paid one-third of regular price for the same drink. SoBe Adrenaline Rush beverage was next promoted as energy for the students' mind, and students after drinking the placebo, had to solve as many word puzzles as possible within thirty minutes. Students who paid regular price for the drink got on average nine correct responses, versus students who paid a discounted price for the same drink got on average 6.5 questions right.

[66] OFT Report (n 59) para 3.130.

[67] Stefano DellaVigna, 'Psychology and Economics: Evidence from the Field' (2009) 47 J of Econ Lit 315, 342; Oren Bar-Gill and Elizabeth Warren, 'Making Credit Safer' (2008) 157 U Pa L Rev 1, 49, 47–52; Samuel Issacharoff and Erin F Delaney, 'Credit Card Accountability' (2006) 73 U Chi L Rev 157, 162–63; for a summary of the recent impact regulatory impact on late fees, see Consumer Financial Protection Bureau, CARD Act Factsheet (February 2011) <http://www.consumerfinance.gov/credit-cards/credit-card-act/feb2011-factsheet/> accessed 7 January 2013.

[68] Bar-Gill and Warren (ibid) 51; DellaVigna (ibid) 321.

[69] Bar-Gill and Warren (n 67) 46.

[70] OFT Report (n 59) paras 3.31, 3.37, 3.43.

[71] *FRONTLINE: The Card Game* (24 November 2009) <http://www.pbs.org/wgbh/pages/frontline/creditcards/view/> accessed 7 January 2013 (interview with former Providian CEO Shailesh Mehta).

The former CEO explained how these ads targeted consumers' optimism: 'When people make the buying decision, they don't look at the penalty fees because they never believe they'll be late. They never believe they'll be over limit, right?'[72]

For other credit card competitors, exploiting consumer biases makes more sense than incurring the costs to debias.[73] If a credit card issuer invests in educating consumers of the likely total costs of using the credit card, their bounded willpower, and their overconfidence, other competitors can free ride on the company's educational efforts and quickly offer similar credit cards with lower fees. Alternatively, the debiased consumers do not remain with the helpful credit card company. Instead they switch to the remaining exploiting credit card firms, where they, along with the other sophisticated customers, benefit from the exploitation (such as getting airline miles for their purchases, while not incurring any late fees).[74] Under either scenario, debiasing reduces the credit card company's profits, without offering any lasting competitive advantage. Consequently, the industry profits more in exploiting consumers' bounded rationality. Naïve consumers will not demand better-suited products. Firms have little financial incentive to help naïve consumers choose better products.[75] Market supply skews toward products and services that exploit or reinforce consumers' bounded willpower and rationality.

This problem, of course, can arise under oligopolies or monopolies. But here entry and greater competition, as one recent survey found, can worsen, rather than improve, the situation:

> The most striking result of the literature so far is that increasing competition through fostering entry of more firms may not on its own always improve outcomes for consumers. Indeed competition may not help when there are at least some consumers who do not search properly or have difficulties judging quality and prices . . . In the presence of such consumers it is no longer clear that firms necessarily have an incentive to compete by offering better deals. Rather, they can focus on exploiting biased consumers who are very likely to purchase from them regardless of price and quality. These effects can be made worse through firms' deliberate attempts to make price comparisons and search harder (through complex pricing, shrouding, etc) and obscure product quality. The incentives to engage in such activities become more intense when there are more competitors.[76]

[72] ibid.

[73] For elegant economic models, see Paul Heidhues, Botond Köszegi and Takeshi Murooka, 'Deception and Consumer Protection in Competitive Markets' in *Pros and Cons of Consumer Protection* (Konkurrensverket Swedish Competition Authority 2011) 44; Xavier Gabaix and David Laibson, 'Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets' (2006) 121 QJ Econ 505, 517–20.

[74] Gabaix and Laibson (n 73) 517–20.

[75] See eg US Dep't of Justice & Fed Trade Comm'n, Horizontal Merger Guidelines (19 August 2010) s 7.2 <http://www.justice.gov/atr/public/guidelines/hmg-2010.html> accessed 7 January 2013 (noting how the market is more vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers after its rivals respond).

[76] OFT Report (n 59) s 6.2; see also Heidhues and others (n 73) 68 (modeling how 'in socially wasteful industries—independent of the number of competitors—firms will keep deceiving consumers even when

Nor is behavioral exploitation the typical cartel problem, whereby firms collude explicitly (agreeing how they will compete or refrain from competing) or tacitly (which still involves detecting and punishing any deviations that 'undermine the coordinated interaction').[77] Instead behavioral exploitation is more like parallel accommodating conduct, where 'each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms'.[78] Firms compete in devising cleverer ways to attract and exploit bounded rational consumers with imperfect willpower.

It is important to note that once we relax the assumptions of rationality and willpower, it does not follow that competition 'always' yields suboptimal outcomes.[79] This suboptimal competition depends first on firms' ability to identify and exploit consumers whose biases, heuristics, and willpower make them particularly vulnerable. Second, after identifying these consumers, firms must be able to exploit them.[80] Third, the payoff from exploiting must exceed the likely payoff from debiasing consumers.[81] Firms lack an incentive to debias if sophisticated consumers, for example, support the exploiting firms as the myopic consumers subsidize their perks.[82] Finally, naïve consumers cannot otherwise quickly debias by being provided information or otherwise learning from their errors and adjusting. Thus, with enough naïve consumers to profitably exploit in these markets, firms will compete in devising better ways to exploit them.

educating them would be costless' and 'have strong incentives to engage in (non-appropriable) exploitative contract innovations—that is in finding new ways of charging consumers unexpected fees—while they have no incentives to engage in (non-appropriable) contract innovations that benefit consumers').

[77] 2010 Merger Guidelines (n 75) s 7.

[78] ibid.

[79] OFT Report (n 59) para 6.3 (noting how 'competition tends to work as standard intuition suggests if biases simply distort consumers' demand without affecting their desire to search for the best deals in light of their demand'); Huffman (n 58) 133; Max Huffman, 'Bridging the Divide? Theories for Integrating Competition Law and Consumer Protection' (2010) 6 Eur Competition J 7.

[80] Financial markets, unlike prediction markets, lack a defined end-point. A rational investor could 'short' a company's stock to profit when the stock price declines. But rational traders do not know when the speculative bubble will burst. Rational traders, due to investor pressure, can be subject to short-term horizons, and follow the herd for short-term gains. Andrei Shleifer and Robert W Vishny, 'The Limits of Arbitrage' (2007) 52 J Fin 35. Alternatively, consumers, recognizing their bounded rationality, can turn for some decisions to more rational advisors or consumer advocates (such as Which? and Consumers Union). Moreover, the window for exploitation can be short-lived. Consumers can make better decisions when they gain experience, quickly receive feedback on their earlier errors, discover their biases and heuristics in their earlier decisions, and take steps to debias. John A List, 'Does Market Experience Eliminate Market Anomalies?' (2003) 118 QJ Econ 41, 41. Rational traders may make more money by creating products that encourage, rather than deter, speculation. Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* (OUP 2000) 172 (citing several examples, including future contracts on tulips during the Tulipmania of the 1630s).

[81] Gabaix and Laibson (n 73) 509, 511.

[82] OFT Report (n 59) paras 3.47–3.52, 4.19 (noting that whenever sophisticated consumers benefit from the exploitation of naïve consumers, firms will have no incentive to debias); Gabaix and Laibson (n 59) 507–9, 517–20 (discussing and modeling the 'curse of debiasing').

Consequently, both antitrust and consumer protection law can complement each other in promoting the opportunity for consumers to choose among the firms' helpful solutions for their problems, while foreclosing suboptimal competition, where companies exploit consumers' biases and imperfect willpower to the consumers' and society's detriment.

Competitive escalation paradigm

The previous subsection describes suboptimal competition to exploit consumers' biases and imperfect willpower. But firms, like consumers, are also susceptible to biases and heuristics. In competitive settings—such as auctions and bidding wars—overconfidence and passion may trump reason, leading participants to overpay for the purchased assets.[83] Unlike demand-driven biases (eg overconfident consumers demanding inappropriate financial products), competition should check supply-driven biases. Consumers, in competitive markets, presumably punish firms' costly biases by taking their business elsewhere. If repeated biased decision-making is not punished, the problem is too little, rather than too much, competition.

One exception is the competitive escalation paradigm, when 'two parties engage in an activity that is clearly irrational in terms of the expected outcomes to both sides, despite the fact that it is difficult to identify specific irrational actions by either party'.[84] To demonstrate this paradigm, Professors Max Bazerman and Don Moore auction a $20 bill.[85] The auction proceeds in dollar increments. The highest bidder wins the $20 bill; but the second highest bidder, as the loser, must pay the auctioneer his or her bid. (So if the highest bid is $4, the winner receives $16; if the second highest bid is $3, the loser must pay $3 to the auctioneer.)

[83] Richard H Thaler, *The Winner's Curse: Paradoxes and Anomalies of Economic Life* (Princeton University Press 1992) 50–62; DellaVigna (n 67) 342. In one experiment, neuroscientists and economists combined brain imaging techniques and behavioral economics research to better understand why individuals overbid. Mauricio R Delgado and others, 'Understanding Overbidding: Using the Neural Circuitry of Reward to Design Economic Auctions' (2008) 321 Science 1849, 1849. Specifically, they examined whether the fear of losing the social competition inherent in an auction game causes people to overpay. Members in the 'loss-frame' group were given 15 dollars at the beginning of each auction round. If they won the auction for that round, they would get to keep the 15 dollars and the payoff from the auction. If they lost, they would have to return the 15 dollars. Members in the 'bonus-frame' group, on the other hand, were told that if they won that auction round they would get a 15-dollar bonus at the end of the round. Whether one gets 15 dollars at the beginning or end of the auction round should not affect a rational player: the winner of each round gets 15 extra dollars, the loser gets nothing. Nonetheless, the loss-frame group members outbid the bonus-frame group members, although both outbid the baseline group.

[84] Max H Bazerman and Don A Moore, *Judgment in Management Decision Making* (7th edn, Wiley 2009) 111. The business literature also discusses the competitive irrationality of firms sacrificing profits and consumer welfare to obtain a relative advantage over a rival. See Lorenz Graf and others, 'Debiasing Competitive Irrationality: How Managers Can Be Prevented from Trading Off Absolute for Relative Profit' (2012) 30 European Management J 386; Dennis B Arnett and Shelby D Hunt, 'Competitive Irrationality: The Influence of Moral Philosophy' (2002) 12 Business Ethics Q 279.

[85] Bazerman and Moore (n 84) 105.

Bidding over $20 for a $20 bill is illogical. Given the cost of losing, it is also illogical to enter a bidding war. But if everyone believes this, no one bids—also illogical. If only one person bids, that person gets a bargain. Once multiple bidders emerge, the second highest bidder fears having to pay and escalates the commitment. As a result, the bidding in experiments with undergraduate students, graduate students, and executives 'typically ends between $20 and $70, but hits $100 with some regularity'.[86]

Bazerman and Moore analogize their experiment to merger contests. Competitors A and B, in their example, fear being competitively disadvantaged if the other acquires cheaply Company C, a key supplier or buyer.[87] Company C, worth $1 billion as a standalone company, is worth $1.2 billion under either Firm A's or B's ownership. If Firm A acquires Company C, then Firm B, having lost its key supplier or buyer, would be significantly disadvantaged, at an estimated cost of $500 million. The same applies to Firm A if Firm B acquires Company C. Firms A and B may rationally decide to enter the bidding contest. Both are better off if the other cannot acquire Company C, nonetheless neither can afford the other to acquire the firm. Firms A and B, to avoid the $0.5 billion loss, could escalate the bidding to around $1.7 billion.[88] One example of this competitive escalation paradigm, argue Bazerman and Moore, is when Johnson & Johnson and Boston Scientific overbid for Guidant.[89]

Here clear antitrust standards can benefit the competitors. If they both know they cannot acquire Company C under the antitrust laws, neither will bid. Antitrust, while not always preventing the competitive escalation paradigm, can prevent overbidding in highly concentrated industries where market forces cannot punish firms that overbid.

When individual and group interests diverge

Suppose the first assumption Fisher identifies is satisfied—people aptly judge what serves their interest, which leads them to maximize their well-being. One avoids the problem of behavioral exploitation and perhaps the competitive escalation paradigm. Nonetheless, as this subsection discusses, competition can be suboptimal if the second key assumption Fisher identifies is relaxed—namely the effort of each person to secure well-being has as its necessary effect to maximize society's overall well-being.

Competition benefits society when individual and group interests and incentives are aligned (or at least do not conflict). Difficulties arise when

[86] ibid 106.
[87] ibid 105.
[88] ibid.
[89] ibid 107–8; Deepak Malhotra, Gillian Ku and J Keith Murnighan, 'When Winning Is Everything' *Harvard Business Review* (May 2008).

individual interests and group interests diverge.[90] Indeed economist Robert Frank recently predicted in a 100 years, most economists will identify as their discipline's intellectual father, Charles Darwin:

> As Darwin saw clearly, the fact that unfettered competition in nature often fails to promote the common good has nothing to do with monopoly exploitation. Rather, it's a simple consequence of an often sharp divergence between individual and group interests.[91]

One area of suboptimal competition is where advantages and disadvantages are relative.[92] Frank used the bull elk as an example. It is in each elk's interest to have relatively larger antlers to defeat other bull elks. But the larger antlers compromise the elks' mobility, handicapping the group overall.[93]

Hockey players are another example. Hockey players prefer wearing helmets. But to secure a relative competitive advantage, one player chooses to play without a helmet. The other players follow. None now have a competitive advantage from playing helmetless. Collectively the hockey players are worse off.[94] Fisher's example involves patrons competing to exit a theater on fire; it is in each individual's interest to get ahead of others, but 'the very intensity of such efforts in the aggregate defeat their own ends'.[95]

A recent example is Wall Street traders who inject testosterone to obtain a competitive advantage.[96] One study found that traders' daily testosterone 'was significantly higher on days when traders made more than their 1-month daily average than on other days'; the 'results suggest that high morning testosterone predicts greater profitability for the rest of that day'.[97] Higher testosterone levels, studies found, increased 'search persistence, appetite for risk, and fearlessness in the face of novelty, qualities that would augment the performance of any trader who had a positive expected return'.[98] Male and female traders, weighing the benefits and risks, can rationally decide to increase their testosterone levels to gain a competitive advantage over other traders (or at least not be competitively disadvantaged against higher testosterone traders).[99] However, as other traders

[90] Fisher (n 55) 22 ('even when the act of an individual is actually for his own benefit, it may not be for the benefit of society').

[91] Robert H Frank, *The Darwin Economy: Liberty, Competition, and the Common Good* (Princeton UP 2011) 16, 138.

[92] Fisher (n 55) 24 ('A general increase in relative advantage is a contradiction in terms, so that in the end the racers as a whole have only their labor for their pains.').

[93] Frank (n 91) 21.

[94] ibid 8–9 [citing Thomas C Schelling, *Micromotives and Macrobehavior* (WW Norton & Co 1978)].

[95] Fisher (n 55) 22.

[96] Charles Wallace, 'Keep Taking the Testosterone' *Financial Times* (10 February 2012) 10; Cindy Perman, 'Wall Streeters Buying Testosterone for an Edge' *CNBC* (12 July 2012) <http://finance.yahoo.com/news/beefy-wall-streeters-traders-rub-185904441.html> accessed 7 January 2013.

[97] JM Coates and J Herbert, 'Endogenous Steroids and Financial Risk Taking on a London Trading Floor' (22 April 2008) 105 PNAS 6167, 6178.

[98] ibid 6170.

[99] See also Reasoned Decision of the United States Anti-Doping Agency on Disqualification and Ineligibility in *United States Anti-Doping Agency v Lance Armstrong* (10 October 2012) 7 ('Twenty of the twenty-one podium

undertake hormone treatments, the traders no longer enjoy a competitive advantage. They and society are collectively worse off.[100]

Below are five additional scenarios where competition for a relative advantage can leave the competitors collectively and society worse off.

How individual and group interests can diverge when firms lobby for a relative competitive advantage

Today corporations and trade groups spend billions of dollars lobbying the federal and state governments.[101] Microsoft, for example, historically did little lobbying.[102] That changed after the United States filed its antitrust lawsuit. Microsoft now spends millions of dollars annually on lobbying.[103] Not surprisingly, given the recent antitrust scrutiny, Google spends even more on lobbying—$9,680,000 alone in 2011.[104]

The Supreme Court quickened the race to the bottom when it substantially weakened the limitations on corporate political spending, and thereby vastly increased the importance of pleasing large donors to win elections.[105] The Court saw itself as removing an important competitive restraint in the marketplace of ideas. But Justice Stevens saw competition's dark side:

> In this transactional spirit, some corporations have affirmatively urged Congress to place limits on their electioneering communications. These corporations fear that

finishers in the Tour de France from 1999 through 2005 have been directly tied to likely doping through admissions, sanctions, public investigations or exceeding the UCI hematocrit threshold. Of the forty-five (45) podium finishes during the time period between 1996 and 2010, thirty-six (36) were by riders similarly tainted by doping.').

[100] Coates and Herbert (n 97) 6170 (noting studies that 'if testosterone continued to rise or became chronically elevated, it could begin to have the opposite effect on P&L and survival, because testosterone has also been found to lead to impulsivity and sensation seeking, to harmful risk taking, and, among users of anabolic steroids, to euphoria and mania').

[101] <http://www.opensecrets.org/lobby/> accessed 7 January 2013. Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (Pantheon 2010) 90–92, 179, 192 ('As of October 2009, 1,537 lobbyists representing financial institutions, other businesses, and industry groups had registered to work on financial regulation proposals before Congress—outnumbering by twenty-five to one the lobbyists representing consumer groups, unions, and other supporters of stronger regulation.'); Maurice E Stucke, 'Crony Capitalism and Antitrust' CPI Antitrust Chronicle, Oct 2011 (2) <http://ssrn.com/abstract=1942045> accessed 7 January 2013.

[102] Jeffrey H Birnbaum, 'Learning From Microsoft's Error, Google Builds a Lobbying Engine' *Washington Post* (20 June 2007) D1 ('For a couple of embarrassing years in the mid-1990s, Microsoft's primary lobbying presence was "Jack and his Jeep"—Jack Krumholz, the software giant's lone in-house lobbyist, who drove a Jeep Grand Cherokee to lobbying visits.'). Lobbyists have sought to influence antitrust decisions for years. Maurice E Stucke, 'Does the Rule of Reason Violate the Rule of Law?' (2009) 42 UC Davis L Rev 1375, 1446–56. If anything is new (starting with *Microsoft*), observed Bert Foer, it is probably the fairly standard retention in large antitrust cases of public relation firms and media strategists, who have an easier time in the absence of a dedicated and expert antitrust media.

[103] Center for Responsive Politics, Heavy Hitters, Microsoft Corp <http://www.opensecrets.org/orgs/summary.php?cycle=A&type=P&id=D000000115> accessed 29 September 2011 ('Between 2000 and 2010, Microsoft spent at least $6 million each year on federal lobbying efforts.'). Microsoft spent $7,335,000 in 2011 <http://www.opensecrets.org/orgs/summary.php?id=D000000115> accessed 7 January 2013.

[104] <http://www.opensecrets.org/lobby/clientsum.php?id=D000022008&year=2011> accessed 7 January 2013; Michael Liedtke, 'Google's Lobbying Bill Tops Previous Record' *Associated Press* (21 July 2011) <http://www.huffingtonpost.com/2011/07/21/googles-lobbying-bill-q2-2011_n_906149.html> accessed 7 January 2013.

[105] *Citizens United v Fed Election Comm'n* 130 S Ct 876, 910, 175 L Ed 2d 753 (2010).

> officeholders will shake them down for supportive ads, that they will have to spend increasing sums on elections in an ever-escalating arms race with their competitors, and that public trust in business will be eroded. A system that effectively forces corporations to use their shareholders' money both to maintain access to, and to avoid retribution from, elected officials may ultimately prove more harmful than beneficial to many corporations. It can impose a kind of implicit tax.[106]

The competitive pressure to lobby for a relative advantage (or prevent a relative disadvantage) harms the firms collectively as they 'feel compelled to keep up with their competitors, particularly in the face of a shakedown by elected officials who write the laws and regulations that corporations must follow on a daily basis'.[107] This arms race also undermines a democracy.[108] Part of the current malaise, the Occupy Wall Street movement reflects, is the distrust in government given its capture to special interests.[109]

How individual and group interests can diverge when firms behave unethically for a relative competitive advantage

When auditor Ernst and Young recently surveyed nearly 400 chief financial officers, its findings were disturbing:

- When presented with a list of possibly questionable actions that may help the business survive, 47 per cent of CFOs felt one or more could be justified in an economic downturn.
- Worryingly, 15 per cent of CFOs surveyed would be willing to make cash payments to win or retain business and 4 per cent view misstating a company's financial performance as justifiable to help a business survive.

[106] *Citizens United* (ibid) 973 (Stevens, J, concurring in part and dissenting in part) (internal citation omitted); see also Daniel A Farber and Philip P Frickey, 'The Jurisprudence of Public Choice' (1987) 65 Tex L Rev 873, 906–7:

> No group can afford to drop out of the contest for government handouts; members of a group that did would pay the same taxes but receiver fewer benefits, thus redistributing income to the remaining contestants. As in the 'prisoner's dilemma' game, however, the result of this individually rational behavior is that everyone is worse off. This creates a kind of 'race to the bottom,' in which pork-barrel politics displaces pursuit of the public interest—a situation individuals may deplore even as they find themselves compelled to participate. Even if everybody belonged to a special interest group, so that special interest politics did not affect the distribution of wealth, interest groups still would direct resources to socially unproductive programs.

[107] Brief of the Center for Political Accountability and the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School as Amici Curiae in Support of Appellee on Supplemental Question, *Citizens United v Federal Election Commission*, 2009 WL 2349016 (US) 4.

[108] Albert R Hunt, 'Letter From Washington: Super PACs Fuel a Race to the Bottom' *NY Times* (4 March 2012) <http://www.nytimes.com/2012/03/05/us/05iht-letter05.html?pagewanted=all> accessed 7 January 2013.

[109] Maurice E Stucke, 'Occupy Wall Street and Antitrust' (2012) 85 Southern California L Rev Postscript 33.

- While 46 per cent of total respondents agree that company management is likely to cut corners to meet targets, CFOs have an even more pessimistic view (52 per cent).[110]

Competition, economist Andrei Shleifer discusses, can pressure companies to engage in unethical or criminal behavior, if doing so yields the firm a relative competitive advantage.[111] Other recent economic literature discusses how competition can encourage companies to:

- invest less in legal compliance and more likely violate the law,[112]
- pay kickbacks to secure business,[113]
- underreport profits to avoid taxes,[114] and
- manipulate the ordering protocols on liver transplants.[115]

The studies' underlying theme is that as competition increases, and profit margins decrease, firms have greater incentive to engage in unethical behavior that improves their costs (relative to competitors). Other firms, given the cost disadvantage, face competitive pressure to follow; such competition collectively leaves the firms and society worse off.[116]

Not surprisingly the business literature currently argues for a 'more sophisticated form of capitalism, one imbued with a social purpose'.[117] In the past, the concepts of sustainability, fairness, and profitability generally were seen as conflicting. But under a shared value worldview, these concepts are

[110] Ernst & Young, 12th Global Fraud Survey Growing Beyond: a place for integrity, CFOs in the spotlight <http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation—Dispute-Services/Global-Fraud-Survey—a-place-for-integrity> accessed 7 January 2013.

[111] Andrei Shleifer, 'Does Competition Destroy Ethical Behavior?' (2004) 94 Am Econ Rev 414, 414–16 (discussing how competition can help spread child labor, corruption and bribery of government officials to reduce the amount the companies owe in tariffs and taxes, excessive executive pay, manipulated earnings to lower corporation's cost of capital, and the involvement of universities in commercial activities).

[112] Fernando Branco and J Miguel Villas-Boas, 'Competitive Vices' (May 2012) <http://dx.doi.org/10.2139/ssrn.1921617> accessed 7 January 2013; Brian W Kulik and others, 'Do Competitive Environments Lead to the Rise and Spread of Unethical Behavior? Parallels from Enron' (2008) 83 J of Business Ethics 703.

[113] W Harvey Hegarty and Henry P Sims, 'Some Determinants of Unethical Decision Behavior: An Experiment' (1978) 63 J of Applied Psychology 451, 455–56.

[114] Hongbin Cai and Qiao Liu, 'Competition and Corporate Tax Avoidance: Evidence From Chinese Industrial Firms' (2009) 119 Economic J 764, 765–66.

[115] Jason Snyder, 'Gaming the Liver Transplant Market' J L Econ Organization (Advance Access Published 1 April 2010). Using the policy changes in ranking kidney transplant candidates, the study examined changes in hospitals' behavior in admitting kidney transplant candidates into the intensive care unit (which under the former policy increased the candidates' ranking). After the policy change, the use of the ICU decreased more in markets with more transplant centers and the percentage of relatively healthy people in the ICU decreased most in the areas with more firms. 'It appears that each competing center used the ICU to move their sickest patients to the top of the list and had a negligible overall impact on the rank ordering of patients waiting for a liver.' ibid 3.

[116] Kent Greenfield, 'Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (with Notes on How Corporate Law Could Reinforce International Law Norms)' (2001) 87 Va L Rev 1279, 1349–51 ('Without such a term, the pressure on corporate managers to make money for the firm would force managers to compete to their collective detriment through illegality.').

[117] Michael E Porter and Mark R Kramer, 'Creating Shared Value: How to Reinvent Capitalism—and Unleash a Wave of Innovation and Growth' *Harvard Business Review* (January–February 2011) 62, 77; see also Dominic Barton, 'Capitalism for the Long Term' *Harvard Business Review* (March 2011); Rosabeth Moss Kanter, 'How Great Companies Think Differently' *Harvard Business Review* (November 2011) 66; 'Symposium on Conscious Capitalism' (2011) 53 California Management Rev 60 ff.

reinforcing.[118] Profits can be attained, not through a competitive race to the bottom, but in better helping address societal needs.

How individual and group interests can diverge when financial institutions undertake additional risk for a relative competitive advantage

The conflict between collective and individual interests arose in the financial crisis. Banks, the OECD described, are prone to take substantial risks:

> First, the opacity and the long maturity of banks' assets make it easier to cover any misallocation of resources, at least in the short run. Second, the wide dispersion of bank debt among small, uninformed (and often fully insured) investors prevents any effective discipline on banks from the side of depositors. Thus, because banks can behave less prudently without being easily detected or being forced to pay additional funding costs, they have stronger incentives to take risk than firms in other industries. Examples of fraud and excessive risk are numerous in the history of financial systems as the current crisis has also shown.[119]

An overleveraged financial institution can ignore the small probability that its risky conduct in conjunction with its competitors' risky conduct may bring down the entire economy.[120] To gain additional profits and a competitive advantage, each firm will incur greater leverage. Even for rational-choice theorists like Richard Posner, the government must be a countervailing force to such self-interested rational private behavior by better regulating financial institutions.[121] Otherwise competition among rational self-interested

[118] Porter and Kramer (ibid) 64, 66 (Shared value 'involves creating economic value . . . for society by addressing its needs and challenges' and 'enhanc[ing] the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates.').

[119] OECD, *Bank Competition and Financial Stability* (OECD Publishing 27 October 2011) 24.

[120] One court found a compelling inference from the complaint that:

> the Officer Defendants were deliberately reckless in their public statements regarding loan quality and underwriting. First, the confidential witness statements describe a staggering race-to-the-bottom of loan quality and underwriting standards as part of an effort to originate more loans for sale through secondary market transactions. The witnesses catalogue an explosive increase in risky loan products, including interest-only loans, stated income loans, and adjustable-rate loans, and a serious decline in loan quality and underwriting. . . . Several witnesses portray an underwriting system driven by volume and riddled with exceptions. They state that the goal was to 'push more loans through,' that 'there was always someone to sign off on any loan,' that nearly any loan was approved to meet its sales projections, and that exceptions were commonly made for the otherwise unqualified. There are specific instances of loose standards, as when an employee recommended denial of a loan application but higher-level managers repeatedly approved those loans, or when underwriters allowed rejected loans, usually because borrowers' incomes were too low, a second chance and approved the formerly rejected loans. There is testimony that instructions, according to managers, came from the corporate officers, and that officers had access to information on the effects of these practices, including the rising defaults. There are also indications that the compensation for sales reinforced the disregard for standards and quality as volume was linked to reward.

In re New Century 588 F Supp 2d 1206, 1229 (CD Cal 2008) (citations to complaint omitted).

[121] Richard A Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent Into Depression* (Harvard UP 2009) xii, 242–43; see also OECD (n 119) 28–29 ('Regulation should help to reduce the potential for any detrimental effects of competition on financial stability, in particular, by making banks less inclined to take on excessive risks.').

'law-abiding financiers and consumers can precipitate an economic disaster'.[122]

One may ask if competition is the problem, then is monopoly the cure. The remedy is neither monopoly nor overregulation (which besides impeding competition, stifles innovation and renders the financial system inefficient or unprofitable). But the remedy is not simply more competition, which can increase the financial system's instability, as banks increase leverage and risk.[123] Instead, the financial industry must be 'competitive enough to provide a range of services at a reasonable price for consumers, but [is] not prone to periods of excess competition, where risk is under priced (for example, to gain market share) and competitors fail as a result with systemic consequences'.[124]

How individual and group interests can diverge when firms demand Most-Favored-Nation (MFN) clauses for a relative competitive advantage

MFN clauses, the subject of two recent DOJ enforcement actions, are topical.[125] Some courts have embraced MFNs as pro-competitive. MFN clauses, Posner wrote, 'are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers'.[126] This 'is the sort of conduct that the antitrust laws seek to encourage'.[127] Likewise, another court found that the MFN's 'insisting on a supplier's lowest price—assuming that the price is not "predatory" or below the supplier's incremental cost—tends to further competition on the merits'.[128] It seemed 'silly' to the court 'to argue that a policy to pay the same amount for the same service is anticompetitive, even on the part of one who has market power. This, it would seem, is what competition should be all about'.[129]

Antitrust scholarship has identified MFN's potential anticompetitive effects.[130] The purpose here is to illustrate how individual and collective interests

[122] Posner (n 121) 107; see also ibid 111–12.

[123] *US v Philadelphia Nat Bank* 374 US 321, 380 (1963) (noting how '[u]nrestricted bank competition was thought to have been a major cause of the panic of 1907 and of the bank failures of the 1930's, and was regarded as a highly undesirable condition to impose on banks in the future').

[124] OECD (n 119) 9.

[125] Compl para 65, *US v Apple, Inc*, Civ Action No 1:12-cv-02826-UA (SDNY filed 11 April 2012) <http://www.justice.gov/atr/cases/applebooks.html> accessed 7 January 2013 (challenging, inter alia, 'unusual' MFN whereby the book publishers agreed to lower the retail price of their e-books on Apple's iBookstore to the lowest price by any other retailer); Compl, *US v Blue Cross Blue Shield of Mich.*, Civ Action No 2:10-cv-15155 (ED Mich filed 18 October 2010) <http://www.justice.gov/atr/cases/f263200/263235.pdf> accessed 7 January 2013.

[126] *Blue Cross & Blue Shield United of Wisconsin v Marshfield Clinic* 65 F 3d 1406, 1415 (7th Cir 1995).

[127] *Marshfield Clinic* (ibid). The DOJ and FTC supported a rehearing en banc in part because of the court's permissive language on MFNs. Brief for the USA and FTC as Amici Curiae in Support of Petition for Rehearing, *Blue Cross & Blue Shield United of Wisconsin v Marshfield Clinic* 65 F 3d 1406 (7th Cir filed 2 October 1995) <http://www.justice.gov/atr/cases/f0400/0421.htm#N_2_> accessed 7 January 2013.

[128] *Ocean State Physicians Health Plan, Inc v Blue Cross & Blue Shield of Rhode Island* 883 F 2d 1101, 1110 (1st Cir 1989).

[129] ibid.

[130] Jonathan B Baker, 'Vertical Restraints With Horizontal Consequences: Competitive Effects of 'Most-Favored-Customer' Clauses' (1996) 64 Antitrust LJ 517; Arnold Celnicker, 'A Competitive Analysis of Most Favored Nations Clauses in Contracts Between Health Care Providers and Insurers' (1991) 69 NC L Rev 863, 883–91.

diverge in competitive environments, leaving buyers collectively worse off. The FTC in *Ethyl* described this divergence:

> An individual customer may rationally wish to have advance notice of price increases, uniform delivered pricing, or most favored nation clauses available in connection with the purchase of antiknock compounds. However, individual purchasers are often unable to perceive or to measure the overall effect of all sellers pursuing the same practices with many buyers, and do not understand or appreciate the benefit of prohibiting the practices to improve the competitive environment . . . .a most favored nation clause is perceived by individual buyers to guarantee low prices; whereas widespread use of the clauses has the opposite effect of keeping prices high and uniform. In short, marketing practices that are preferred by both sellers and buyers may still have an anticompetitive effect.[131]

The appellate court, however, disagreed.[132] The MFN, observed the court, 'assured the smaller refiners that they would not be placed at a competitive disadvantage on account of price discounts to giants such as Standard Oil, Texaco and Gulf'.[133]

What the appellate court failed to grasp is that MFNs—while individually rational—can be collectively irrational.[134] MFNs assure buyers that others during a specific time period will not pay a lower price. If the buyers fiercely compete, MFNs seemingly provide a relative cost advantage. The buyer need not expend time and expense to negotiate a lower price; it can free ride on other buyers' efforts. It is in each buyer's individual interest to secure this cost advantage; thus buyers may demand, and sellers may offer, MFN protection.[135] Competition drives buyers to demand MFN protection to lower their transaction costs; the number of buyers willing to invest in procuring a discount shrink. (Why should they uniquely incur the cost, when the benefits accrue to their rivals?) Accordingly, 'buyer competition to obtain most-favored-customer protection, in the end, can cost buyers as a group'.[136]

[131] Matter of Ethyl Corp, 101 FTC 425 (1983), vacated by *EI du Pont de Nemours & Co v FTC* 729 F 2d 128 (2d Cir 1984); see also Fiona Scott-Morton, Deputy Assistant Attorney General, US Dep't of Justice, Antitrust Div., Contracts that Reference Rivals, Presented at Georgetown University Law Center Antitrust Seminar (5 April 2012) <www.justice.gov/atr/public/speeches/281965.pdf> accessed 7 January 2013 (making similar point, stating 'Indeed, the idea that the buyer requests the MFN, and that the MFN will deliver a lower price to the buyer, is a common intuition for why MFNs should be procompetitive.').

[132] *du Pont* (ibid) 729 F 2d at 134.

[133] ibid.

[134] Baker (n 130) 533 ('when buyers desire something individually, one cannot assume, as these courts have done, that it is in the buyers' interest collectively to obtain it'). The appellate court may have ruled otherwise if the sellers 'adopted or continued to use the most favored nation clause for the purpose of influencing the price discounting policies of other producers or of facilitating their adoption of or adherence to uniform prices.' *du Pont* 729 F 2d at 134. Whether MFNs are demand-driven (customers seeking to maximize their self-interest) or supply-driven (sellers marketing MFNs), once MFNs are widespread in the industry, the anticompetitive outcome is the same—higher equilibrium prices. Perhaps the appellate court believed that sellers are more blameworthy if they actively promote MFNs for an ulterior anticompetitive purpose rather than responding to consumer demand.

[135] Scott-Morton (n 131).

[136] Baker (n 130) 533.

How individual and group interests can diverge when consumers compete for status

Status competition epitomizes competition for relative position among consumers with interdependent preferences.[137] The ancient Greek and Roman philosophers,[138] early Christian theologians,[139] and economists Adam Smith[140] and Thorstein Veblen[141] described how status competition is never won. Either people adapt to their fancier lifestyle, and envy those on the higher rung.[142] Or others catch up in their consumption (eg similarly large homes, extravagant parties), increasing the demand for conspicuous consumption or leisure that provide a relative advantage.

Despite status competition's durability and prevalence, few praise it. C. S. Lewis, for example, observed that pride generally is the 'essential vice' and 'complete anti-God state of mind'.[143] Pride is competition awry: 'Pride is *essentially* competitive—is competitive by its very nature—while the other vices are competitive only, so to speak, by accident.'[144] Pride, Lewis also wrote, 'has been the chief cause of misery in every nation and every family since the world began'.[145]

Status competition not only taxes individuals but society overall.[146] As economists that study subjective well-being conclude, '[h]igher-income aspirations reduce people's satisfaction with life.'[147] Wealthier people impose a

[137] Angela Chao and Juliet B Schor, 'Empirical Tests of Status Competition: Evidence from Women's Cosmetics' (1998) 19 J of Economic Psychology 107, 108–9.

[138] Seneca, 'Letter CXXIII' in *Letters from a Stoic* (Robin Campbell trs, Penguin Books 1969) 227 (observing how some gadgets are purchased not because of their inherent utility, but 'because others have bought them or they're in most people's houses'); Plutarch, 'On Contentment' in Ian Kidd (ed) and Robin H Waterfield (trans), *Essays* (Penguin Books 1992) 222 (observing how prisoners 'envy those who have been freed, who envy those with citizen status, who in turn envy rich people, who envy province commanders, who envy kings, who—because they almost aspire to making thunder and lightning—envy the gods').

[139] Saint Augustine, *Confessions* (Penguin Books 1961) 33 (acknowledging 'man's insatiable desire for the poverty he calls wealth'); Saint Thomas Aquinas, *Compendium Theologiae*, reprinted in *Aquinas's Shorter Summa* (2002) 353–56.

[140] Adam Smith, *The Theory of Moral Sentiments* (A. Millar. 1790. Library of Economics and Liberty [Online] <http://www.econlib.org/library/Smith/smMS4.html>; accessed 26 September 2012) IV.I.8, 183 (trinkets' real purpose is to 'more effectually gratify that love of distinction so natural to man').

[141] Thorstein Veblen, *The Theory of the Leisure Class* (Penguin Books 1994) (1899) 26, 103–4 (observing that the predominant motive for conspicuous consumption is the 'invidious distinction attaching to wealth'). The accumulation of goods and services forms the conventional basis of esteem. Veblen observed the hedonic treadmill: '[T]he present pecuniary standard [marks] the point of departure for a fresh increase in wealth; and this in turn gives rise to a new standard of sufficiency and a new pecuniary classification of one's self as compared with one's neighbors.' ibid 31.

[142] Alois Stutzer and Bruno S Frey, 'Recent Advances in the Economics of Individual Subjective Well-Being' (Summer 2010) 77 Social Research 679, 690; Seneca, 'Letter CIV' in *Letters from a Stoic* (n 138) 186 ('However much you possess there's someone else who has more, and you'll be fancying yourself to be short of things you need to the exact extent to which you lag behind him.').

[143] CS Lewis, *Mere Christianity* (1952) (HarperCollins 2000) 121–22.

[144] ibid 122.

[145] ibid 123–24; see also Veblen (n 141) 31 (chronically dissatisfied with his present lot, man will strain to place 'a wider and ever-widening pecuniary interval between himself and the average standard'); Smith (n 140) 184.

[146] Fisher (n 55) 25; Frank (n 91) 76–81 (discussing a progressive consumption tax).

[147] Stutzer and Frey (n 142) 691; Richard Layard 'Happiness & Public Policy: A Challenge to the Profession' (2006) 116 The Economic J C24–33.

negative externality on poorer people.[148] Antitrust norms, such as a per se prohibition of resale price maintenance for status goods,[149] are also difficult to reconcile with status competition where individual and collective interests can diverge to consumers' and society's detriment.[150]

Status competition has confounded consumers and economists for centuries. John Maynard Keynes, for example, assumed that with greater productivity and higher living standards, people in developed economies would work only fifteen hours per week.[151] He identified two classes of needs—'those needs which are absolute in the sense that we feel them whatever the situation of our fellow human beings may be, and those which are relative in the sense that we feel them only if their satisfaction lifts us above, makes us feel superior to, our fellows.'[152] As its economy developed, Keynes predicted, society would deemphasize the importance of relative needs.[153]

So why aren't many Americans, Europeans, and Asians today working 15 or 20 hours per week? Keynes correctly predicted the rise in productivity and real living standards. But he 'underestimated the appeal of materialism'.[154] Fisher, however, grasped this:

> Much has been said of late about the importance of living the simple life, but so far as I know there has been no analysis to show why it is not lived. This analysis would

[148] Stutzer and Frey (n 142) 690; Bruno S Frey, *Happiness: A Revolution in Economics* (MIT Press 2008) 31.

[149] Each purchaser's individual interest is to purchase the status good at a discount, while others pay the full retail price to preserve the product's symbol of conspicuous consumption. Maurice E Stucke, 'Money, Is That What I Want? Competition Policy & the Role of Behavioral Economics' (2010) 50 Santa Clara L Rev 893; Barak Y Orbach, 'Antitrust Vertical Myopia: The Allure of High Prices' (2008) 50 Ariz L Rev 261, 286. Likewise, each retailer's individual interest is to offer a discount while its competitors charge the full price. Absent RPM, a race to the bottom, here the discount bin, ensues. As retailers discount, more consumers can afford the status good. But the good's status value decreases. Early adopters disapprove of the brand's commoditization, and switch to other status symbols. As more consumers disapprove of the brand as cheap and vulgar, the manufacturer and retailers lower price to maintain demand levels (primarily among consumers who previously could not afford the item). Arguably banning RPM could reduce status competition. Far-sighted consumers can see the natural cycle of early adoption, emulation, and rejection. Why purchase the $100 polo shirt that in several years retails for $30? But this proves too much. Far-sighted consumers would recognize the tax and misery imposed by status competition, and forego status competition whether RPM was legal or illegal.

[150] Group boycotts and agreements to restrict purchases are per se illegal. But suppose consumers collectively agreed to disarm the birthday party arms-race by boycotting expensive toys, gift bags, and birthday entertainers. William Doherty, 'Beyond the Consulting Room—Therapists as Catalysts of Social Change' <http://www.psychotherapynetworker.org/symposium-2011/326-522-after-the-affair-> accessed 7 January 2013; see also <http://www.cehd.umn.edu/fsos/projects/birthdays/parents.asp#gifts> accessed 7 January 2013. To curb this social competition, neighborhood parents undertake a Green Birthday Pledge, where they collectively agree to 'a "no-gift" or "giving party" or a "swap party" to cut back on unwanted toys and excess packaging and wrapping' and skipping 'the goody bag loaded with cheap plastic toys and candy'. <http://www.enviromom.com/host-a-green-birthday-par.html> accessed 7 January 2013. Only an overzealous antitrust official would prosecute their group boycott.

[151] John Maynard Keynes, 'Economic Possibilities for Our Grandchildren' in *Essays In Persuasion* (1932) 358, 369 ('For three hours a day is quite enough to satisfy the old Adam in most of us!').

[152] ibid 365.

[153] ibid 369–70.

[154] Jonathan Guthrie, 'Anything to Distract Us from the Arts of Life' *Financial Times* (30 April 2009) 11 (quoting Professor Alan Manning).

reveal that the failure to live it is due to a kind of unconscious cut-throat competition in fashionable society.[155]

Status competition is often, but not always, detrimental. On the bright side, people voluntarily compete and use Internet peer pressure to change their energy consumption, driving, and exercise habits.[156] But status competition is often suboptimal. One interesting empirical study sought to understand why academics cheated by inflating the number of times their papers were downloaded on the Social Science Research Network (SSRN).[157] SSRN ranks authors, their papers, and their academic institutions by the number of times the papers are downloaded.[158] Some authors repeatedly downloaded their own papers to inflate the publicly recorded download count. Why the deception? Status competition, the study found, was a key contributor.[159]

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In all five scenarios, competitors seek a relative advantage that ultimately leaves them collectively and society worse off. This suboptimal competition is not a new concept. Many, however, used a pejorative term, instead of competition, to describe it, such as:

- a collective action problem,[160]
- a race to the bottom or regulatory arbitrage—where states compete away environmental, safety, and labor protections to obtain a relative advantage,[161] or

[155] Fisher (n 55) 25.

[156] Tim Bradshaw, 'Peer Groups that Harness an Online Community Spirit' *Financial Times* (6 August 2009) 12.

[157] Benjamin G Edelman and Ian Larkin, 'Demographics, Career Concerns or Social Comparison: Who Games SSRN Download Counts?' Harvard Business School NOM Unit Working Paper No 09-096 (19 February 2009) <http://ssrn.com/abstract=1346397> accessed 7 January 2013.

[158] <http://www.ssrn.com/> accessed 7 January 2013.

[159] Edelman and Larkin (n 157) 4, 17 (finding 'strong evidence that envy and social comparisons play a strong role in predicting deceptive downloads. Higher levels of reported downloads for three separate peer groups—an author's institution, other [peers] within an SSRN e-journal, and [peers] within an e-journal publishing papers on SSRN at about the same time as the author in question—are associated with 12% to 30% more invalid downloads.').

[160] Frank (n 91) 9.

[161] H Geoffrey Moulton, Jr, 'Federalism and Choice of Law in the Regulation of Legal Ethics' (1997) 82 Minn L Rev 73, 136–41 ('Most often employed in the contexts of environmental and corporate regulation, the "race to the bottom" argument for national intervention posits that state competition for jobs, industry, and investment will lead states to adopt lower-than-optimal regulatory standards. . . . In other words, a state government acting strategically may rationally conclude that lax regulatory standards will increase its constituents' welfare (by increasing investment and employment) by an amount greater than any (in-state) costs resulting from the lower standards. Other states, however, will naturally relax their own standards in response, in order to get ahead themselves or not be left behind, "triggering a downward regulatory spiral and nonoptimal results."'); *Hodel v Virginia Surface Mining* 452 US 264, 268, 281–82 (1981) (noting Surface Mining Control and Reclamation Act responds to congressional concern that 'nationwide 'surface mining and reclamation standards are essential in order to insure that competition in interstate commerce . . . will not be used to undermine the ability of the several States to improve and maintain adequate standards," and holding that '[t]he prevention of this sort of destructive interstate competition is a traditional role for congressional action under the Commerce

- rational irrationality, whereby the 'application of rational self-interest in the marketplace leads to an inferior and socially irrational outcome'.[162]

Some may argue that these scenarios simply involve competitors' imposing negative externalities on one another. Negative externalities typically involve 'situations when the effect of production or consumption of goods and services imposes costs or benefits on others which are not reflected in the prices charged for the goods and services being provided'.[163] Even if one viewed competition itself as a negative externality that a competitor imposes on rivals, an important distinction exists. Firms—independent of any competitive pressure—at times impose a negative externality to maximize profits. For example, electric power utilities, whether or not a monopoly, will seek to maximize profits by polluting cheaply and having the community bear the environmental and health costs. In contrast, as this subsection discusses, competition induces the firm to impose a negative externality, which absent competitive pressure, the firm would 'not' otherwise impose. The utility monopoly, for example, may lobby to keep abay pesky environmentalists, but it would not expend resources on lobbying to secure a relative competitive advantage when its market power is otherwise secure.

When competition among intermediaries reduces accuracy

The previous subsection identifies five scenarios where competition for a relative advantage leaves the competitors and society worse off. This subsection discusses another race to the bottom, namely when consumers pressure an intermediary to shade its findings to the consumers' liking, but society's overall detriment. As competition increases in the intermediary's market, more will be willing to distort their findings and reduce accuracy, which may appeal to the individual customers, but harms society overall.

Underlying democracies is the belief that competition fosters the marketplace of ideas: truth prevails in the widest possible dissemination of information from diverse and antagonistic sources.[164] Competition should, and often does, improve accuracy.[165]

Clause'); *Louis K Liggett Co v Lee* 288 US 517, 557–60 (1933) (Brandeis, J, dissenting in part) (noting how the leading industrial state governments relaxed the legal limits upon business corporations' size and powers not because they believed that these restrictions were undesirable, but to compete with the lesser states, which eager for the revenue, removed these legal safeguards: 'The race was one not of diligence but of laxity.').

[162] John Cassidy, *How Markets Fail: The Logic of Economic Calamities* (Farrar, Straus and Giroux 2009) 142.

[163] 'Externalities' in *Glossary of Industrial Organisation Economics and Competition Law*, compiled by RS Khemani & DM Shapiro, commissioned by the Directorate for Financial, Fiscal and Enterprise Affairs, OECD, 1993; *McCloud v Testa* 97 F 3d 1536, 1561 n21 (6th Cir 1996) (negative externalities arise 'when the private costs of some activity are less than the total costs to society of that activity', so that 'society produces more of the activity than is optimal because private parties engaging in that activity essentially shift some of their costs onto society as a whole').

[164] Maurice E Stucke and Allen P Grunes, 'Antitrust and the Marketplace of Ideas' (2001) 69 Antitrust LJ 249.

[165] Matthew Gentzkow and Jesse M Shapiro, 'Competition & Truth in the Market for News' (2008) 22 J of Economic Perspectives 133; Stefano DellaVigna and Ethan Kaplan, 'The Political Impact of Media Bias' in Roumeen Islam (ed), *Information and Public Choice: From Media Markets to Policy Making* (World Bank 2008).

But competition can decrease accuracy when intermediaries, who monitor or report market participants' businesses, property, goods, services, or behavior, also compete for the market participants' business. One cannot characterize this simply as an incentives problem, whereby the intermediary shades its findings to the customers' liking because the customer pays for the service. For if the problem were attributable primarily to misaligned incentives, then the problem would arise in duopolies, and be unaffected by entry and increased competition. Here, misaligned incentives play an important role, but so do increased entry and competition.[166] The concern is that competition increases the pressure on intermediaries to engage in unethical behavior.

This subsection discusses two industries, where, as recent economic studies found, greater competition yielded more unethical conduct among intermediaries. But this problem can arise in other markets as well. Home appraisers, pressured by threats of losing business to competitors, inflate their valuations to the benefit of real estate brokers (who gain higher commissions) and lenders (who make bigger loans and earn greater returns when selling them to investors).[167] Facing competitive pressure, lawyers can also adopt 'a stronger adversarial and client-centered approach in the hope that this stance will be rewarded by clients' preferences'; more complaints about lawyer misconduct ensue.[168] Thus markets where intermediaries can manipulate information and test results can enjoy greater efficiency with less competition.

[166] Indeed entry may make everyone worse off. An empirical study found that higher housing prices attracted more real-estate brokers into that market. Chang-Tai Hsieh and Enrico Moretti, 'Can Free Entry Be Inefficient? Fixed Commissions and Social Waste in the Real Estate Industry' (2003) J of Political Economy 1076. The brokers did not benefit. Their productivity (houses sold per hours worked) on average declined and their real wages remained the same. Consumers did not benefit. They paid higher brokerage fees, which were fixed on a percentage of the increasing home values. Accordingly, the study concluded that '[i]ncreases in housing prices translate into pure economic losses since brokers are not made better off but consumers are made worse off.' ibid 1118. Another study of real-estate agents in the greater Boston, Massachusetts area found that new entrants likelier take listings from bottom tier incumbents and 'no evidence that consumers benefit from enhanced competition associated with entry either on sales probability or time to sale'. Panle Jia Barwick and Parag A Pathak, 'The Costs of Free Entry: An Empirical Study of Real Estate Agents in Greater Boston' (September 2012) Working Paper 32 <http://economics.mit.edu/faculty/pjia/working> accessed 7 January 2013.

[167] Vikas Bajaj, 'New York Says Appraiser Inflated Value of Homes' *NY Times* (2 November 2007) <http://www.nytimes.com/2007/11/02/business/02appraise.html> accessed 7 January 2013; Les Christie, 'Taming Inflated Home Appraisals: New Guidelines Aim to Reduce the Pressure that Real Estate Appraisers Feel to Boost Home Values' *CNNMoney* (14 January 2009) <http://money.cnn.com/2009/01/14/real_estate/appraisal_reform/index.htm> accessed 7 January 2013; Kenneth R Harney, 'Appraisers Say Pressure on Them to Fudge Values is Up Sharply' *RealtyTimes* (5 February 2007) <http://realtytimes.com/rtpages/20070205_appraisers.htm> accessed 7 January 2013 (90 per cent of 1200 surveyed real estate appraisers said mortgage brokers, realty agents, lenders and individual home sellers pressured them to raise property valuations, a huge increase over the 2003 survey results, and 75 per cent of appraisers reported 'negative ramifications' when they declined requests for inflated valuations); Julie Haviv, 'Some US Appraisers Feel Pressure To Inflate Home Values' *Wall Street Journal* (9 February 2004) (citing 2003 October Research survey of 500 fee appraisers across the country, with at least five years of experience in the residential real estate appraisal business, that 55 per cent said they have felt pressure to inflate the values of properties, with 25 per cent of those respondents saying it happens nearly half the time) <http://www.octoberresearch.com/about-news-releases-details.cfm?ID=4> accessed 7 January 2013.

[168] Neta Ziv, 'Regulation of Israeli Lawyers: From Professional Autonomy to Multi-Institutional Regulation' (2009) 77 Fordham L Rev 1763, 1794 & n54 (discussing concerns within Israel about greater lawyer misconduct from increased competition); see also Robin Wellford Slocum, 'The Dilemma of the Vengeful Client: A Prescriptive Framework for Cooling the Flames of Anger' (2009) 92 Marq L Rev 481, 486 ('Within the legal profession itself, an excessive focus on the economic outcomes of legal matters, to the exclusion of psychological and emotional costs, has

Ratings industry

Ratings agencies provide several complementary functions:

> (i) to measure the credit risk of an obligor and help to resolve the fundamental information asymmetry between issuers and investors, (ii) to provide a means of comparison of embedded credit risk across issuers, instruments, countries and over time; and (iii) to provide market participants with a common standard or language to use in referring to credit risk.[169]

The DOJ, as one expects from an antitrust agency, advocated for more entry and competition in the ratings industry, which two firms long dominated. The DOJ asked in 1998 the US Securities and Exchange Commission (SEC) to modify its proposed regulations 'so that new rating agencies could more easily enter the market, thereby increasing competition'.[170] The SEC's proposal 'would erect a nearly insurmountable barrier to entry by new and well-qualified firms into the market for securities ratings services', which could have 'chilling effects on competition and could raise prices for securities ratings'.[171] In 2008, in the midst of the financial crisis, the DOJ favorably recalled its advocating 'the SEC to modify its proposed rules for securities ratings agencies so that new rating agencies could more easily enter the market, thereby increasing competition'.[172] The DOJ assumed that increasing competition in the ratings industry would benefit, not harm, investors and society.

One cannot fault the DOJ for assuming that entry, in increasing competition, often benefits consumers. But under an issuer-pays model,[173] increasing competition among the ratings agencies, the OECD found, 'is not an unambiguously positive development, as it can create a bias in favour of inflated ratings under certain circumstances'.[174] This became evident after the financial crisis. As the OECD described:

> The growth and development of the market in structured finance and associated increase in securitisation activity occurred at a time when Fitch Ratings was becoming a viable competitor to Standard & Poor's and Moody's, in effect, breaking up the duopoly the two [rating agencies] had previously enjoyed. The increased competition resulted in significant ratings grade inflation as the agencies competed for market share. Importantly, the ratings inflation was attributable not to the valuation models

contributed to an environment of brutal competition and unethical behavior—an environment where everyone is a potential adversary and trust is a mirage on the horizon.') (internal quotation omitted).

[169] OECD (n 119) 25.

[170] US Dep't of Justice, Antitrust Div, Press Release, DOJ Urges SEC to Increase Competition for Securities Ratings Agencies (6 March 1998) <http://www.justice.gov/atr/public/press_releases/1998/212587.htm> accessed 7 January 2013.

[171] ibid.

[172] Organisation for Economic Co-operation and Development, Directorate for Financial and Enterprise Affairs Competition Committee Competition and Financial Markets, Note by the United States, DAF/COMP/WD(2009)11 (30 January 2009) 10–11.

[173] Issuers, whose securities the agencies rate, pay the fees.

[174] OECD (n 119) 25.

> used by the agencies, but rather to systematic departures from those models, as the agencies made discretionary upward adjustments in ratings in efforts to retain or capture business, a direct consequence of the issuer-pays business model and increased concentration among investment banks. Issuers could credibly threaten to take their business elsewhere.[175]

With the expansion of Fitch Ratings, the competitive pressures on the ratings agencies increased.[176] The ratings agencies' cultures changed. They placed greater emphasis on increasing market share and short-term profits. The novel financial instruments they rated, credit default swaps (CDS) and credit debt obligations (CDOs), were a growing and relatively more profitable sector. A competitive race to the bottom ensued. Moody's in August 2004:

> unveiled a new credit-rating model that Wall Street banks used to sow the seeds of their own demise. The formula allowed securities firms to sell more top-rated, subprime mortgage-backed bonds than ever before. A week later, Standard & Poor's moved to revise its own methods. An S&P executive urged colleagues to adjust rating requirements for securities backed by commercial properties because of the 'threat of losing deals'. The world's two largest bond-analysis providers repeatedly eased their standards as they pursued profits from structured investment pools sold by their clients, according to company documents, e-mails and interviews with more than 50 Wall Street professionals. It amounted to a 'market-share war where criteria were relaxed,' says former S&P Managing Director Richard Gugliada.[177]

As one Moody's executive testified, 'The threat of losing business to a competitor, even if not realized, absolutely tilted the balance away from an independent arbiter of risk towards a captive facilitator of risk capture.'[178] Investment banks, if they did not get the desired rating, threatened to take their business elsewhere.[179] The ratings agencies, intent on increasing market share in this growing, highly profitable sector, complied. As the Financial Crisis Inquiry Commission found, Moody's alone rated nearly 45,000 mortgage-related securities as AAA.[180] In contrast, only six private-sector companies were rated AAA in early 2010.[181]

> In 2006 alone, Moody's put its triple-A stamp of approval on 30 mortgage-related securities every working day. The results were disastrous: 83% of the mortgage securities rated triple-A that year ultimately were downgraded.[182]

[175] ibid 26; see also Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (US GPO 2011) 210.
[176] Bo Becker and Todd Milbourn, 'How Did Increased Competition Affect Credit Ratings?' (2011) 101 J of Fin Econ 493, 494–95.
[177] Elliot Blair Smith, "Race to Bottom' at Moody's, S&P Secured Subprime's Boom, Bust' *Bloomberg* (25 September 2008) <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ax3vfya_Vtdo> accessed 7 January 2013.
[178] FCIC Report (n 175) 210.
[179] ibid.
[180] ibid xxv.
[181] ibid.
[182] ibid.

Even in the staid world of corporate bonds, increased competition among the ratings agencies led to a worse outcome. One empirical economic study looked at corporate bond and issuer ratings between the mid-1990s and mid-2000s. During this period, Fitch Ratings shook up the S&P/Moody's duopoly by substantially increasing its share of corporate bond ratings.[183] It was Moody's and S&P's policy to rate essentially all taxable corporate bonds publicly issued in the USA. So Moody's and S&P, under their policy, should have had little incentive to inflate their ratings for corporate bonds: 'even if an issuer refuses to pay for a rating, the raters publish it anyway as an unsolicited rating and thereby compromise any potential advantage of ratings shopping'.[184] But even here, as competition intensified, ratings quality for corporate bonds and issuers deteriorated with more AAA ratings by S&P and Moody's, and greater inability of the ratings to explain bond yields and predict defaults.[185]

Consequently, increased competition among the ratings agencies, rather than improve ratings quality, reduced quality to society's detriment. It is now the subject of lawsuits—with allegations that the financial institutions, by 'play[ing] the [rating] agencies off one another' and choosing the agency offering the highest percentage of AAA certificates with the least amount of credit enhancements, 'engender[ed] a race to the bottom in terms of rating quality'.[186] The authors of the ratings study concluded that 'competition most likely weakens reputational incentives for providing quality in the ratings industry and, thereby, undermines quality. The reputational mechanism appears to work best at modest levels of competition.'[187]

Automotive emissions testing centers

Another recent economic study empirically tested whether more competition among New York's vehicle emissions testing centers led to a worse outcome—namely testing centers improperly passing vehicles 'to garner more consumer loyalty for delivering to consumers what they want: a passing Smog Check result'.[188]

[183] Becker and Milbourn (n 176) 494 ('In the median industry, Fitch issued less than one in ten ratings in 1997, but approximately a third of ratings by 2007.').

[184] ibid 498.

[185] ibid 496, 513 ('A one standard deviation increase in Fitch's market share is predicted to increase the average firm and bond rating by between a tenth and half of a step (and increases it significantly more for more highly levered firms). Moving from the 25th to the 75th percentile of our competition measure reduces the conditional correlation between ratings and bond yields by about a third and reduces the conditional predictive power for default events at a three-year horizon by two-thirds.').

[186] In re Lehman Bros Mortgage-Backed Sec Litig 650 F 3d 167, 172 (2d Cir 2011); see also In re Bear Stearns Mortg Pass-Through Certificates Litig 08 CIV. 8093 LTS KNF, 2012 WL 1076216 (SDNY Mar 30, 2012) (complaint alleging that '[c]ompounding the problem, banks such as Bear Stearns shopped for Rating Agencies willing to assign their securities top credit ratings, pitting the Agencies against each other and provoking a race to the bottom in rating quality').

[187] Becker and Milbourn (n 176) 499.

[188] Victor Manuel Bennett and others, 'Customer-Driven Misconduct: How Competition Corrupts Business Practices' (2013) Management Science. In press, draft available at <www.hbs.edu/research/pdf/12-071.pdf> 3, accessed 7 January 2013.

In New York, like other states, automobile owners must have their vehicles periodically tested for pollution control. Owners can choose which private testing center to check their auto's compliance with the environmental emission standards. In this market, the government fixed the price of emission testing. So the testing centers competed along non-price dimensions (such as quick testing and passing vehicles that otherwise should flunk).[189] Car owners could retest any failing car at another facility. Moreover, car owners received a one-year waiver if they spent $450 and the vehicle continued to fail. 'With these limitations, the short-term benefit of failing a vehicle pales in comparison to the long-term benefit of retaining the customer's service and repair business.'[190]

Competition among these emissions testing centers, the study found, 'can induce firms to increase quality for their customers in ways that are both illegal and socially costly'.[191] In examining 28,002,043 emissions tests from 11,425 New York automobile emissions testing facilities, the study found that as the number of competitors increased in the local automobile emissions market, so too did the pass rates for cars.[192] It was highly unlikely, the study found, that vehicle differences explained these higher pass rates. Rather increasing competition produced significantly 'more illicit leniency only for those cars for which test results are easiest to manipulate'.[193] Honest testing sites risked losing business to dishonest competitors:

> Under such pressure, firms that strictly follow legal rules may lose considerable market share as customers flee to more lax firms. When competition increases the threat of customer loss, firms are more likely to respond by matching their rivals' behavior and crossing legal boundaries.[194]

Antitrust typically treats entrants as superheroes in deterring or defeating the exercise of market power. Here entrants, the study found, were likelier the villains. New vehicle testing entrants with limited customer bases were 'more likely than incumbents to be lenient in the face of competition'.[195] Entrants, rather than remedy market failure, contributed to it.[196]

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[189] ibid 9.
[190] ibid 8.
[191] ibid 2.
[192] ibid 3.
[193] ibid.
[194] ibid 5.
[195] ibid 3, 15 (finding 'that, while incumbents' pass rates increase in the face of competition ($b = 0.073$, $p < 0.05$), entrants' pass rates respond even more strongly ($b = 0.220$, $p < 0.01$). While an entrant's pass rate is 0.96 percentage points lower than other facilities when entering a market without an incumbent, it rises dramatically as the number of proximate facilities increases. These results suggest that while new entrants may on average be more reluctant to provide illicit quality to customers, their willingness increases when trying to win new customers in more competitive markets.').
[196] ibid 3.

The study's authors concluded with a contrarian view on competition:

> Policy makers must consider whether competition is the ideal market structure when corruption, fraud, or other unethical behaviors yield competitive advantages. If customers indeed demand illicit dimensions of quality, firms may feel compelled to cross ethical and legal boundaries simply to survive, often in response to the unethical behavior of just a few of their rivals. In markets with such potential, concentration with abnormally high prices and rents may be preferable, given the reduced prevalence of corruption.[197]

Conclusion

The Supreme Court recognized that competition could increase vice. But equating 'competition with deception, like the similar equation with safety hazards', was for the Court 'simply too broad'.[198] The Court was willing to assume that competition was 'not entirely conducive to ethical behavior' but that was 'not a reason, cognizable under the Sherman Act, for doing away with competition'.[199] The Court was unwilling to support 'a defense based on the assumption that competition itself is unreasonable'.[200]

This article agrees that a 'suboptimal competition' defense is premature. This article simply examines the initial issue of whether competition in a market economy is always good. If, as this article explores, the answer is no, a separate institutional issue is whether we should allow private parties to deal with these types of failures or whether legislation is required. Once antitrust officials recognize that market competition produces at times suboptimal results, the debate shifts to whether the problem of suboptimal competition can be better resolved privately (by perhaps relaxing antitrust scrutiny to private restraints) or with additional governmental regulations (which in turn raises issues over the form of the regulation and who should regulate). Even if one concludes that private restraints were the solution, the economic literature has not developed sufficiently an analytical framework for courts and agencies to apply, consistent with the rule of law, a suboptimal competition defense. Nor is it necessarily superior that independent agencies or courts (rather than elected officials) determine which industries receive a suboptimal competition defense, when, and under what circumstances. Society may prefer that the more publicly accountable elected officials, despite the risk of rent-seeking, should decide when competition is suboptimal.

[197] ibid 19.
[198] *Nat'l Soc of Prof'l Engineers v US* 435 US 679, 696 (1978).
[199] ibid.
[200] ibid 696, 695 ('Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad').

Accordingly, antitrust officials should continue to advocate competition and challenge private and public anti-competitive restraints. But competition in a market economy, while often good, is not always good. The economic literature draws into question the competition official's traditional remedy of more competition. The literature should prompt officials to inquire when competition promotes behavioral exploitation, unethical behavior, and misery.

Some may fear this weakens competition advocacy, as rent-seekers will use the exceptions described herein to restrict socially beneficial competition. But to effectively advocate competition, officials must understand when more competition is the problem, not the cure. In better understanding these instances when competition does more harm than good, antitrust officials can more effectively debunk claims of suboptimal competition. By undertaking this inquiry, antitrust officials become smarter and better advocates.