A Framework for Policymakers to Analyze Proposed and Existing Antitrust Immunities and Exemptions

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Overview of Proposed Framework for Policymakers to Analyze an Antitrust Immunity

Key procedural safeguards within the framework

1. Transparent and inclusive approach
    a. Initial information gathering process
    b. Codification of all passed immunities (new or renewed) in a single place
2. Burden on proponents in making the case for a new immunity or one up for renewal
    a. Justification for immunity
    b. Balancing of costs and benefits
    c. Least restrictive alternative
3. Sunset provision terminating immunity unless renewed
    a. Optional consideration for renewal
    b. Legislative history from previous passage documents analysis, assumptions, and forecasts for use in any renewal process

Summary of framework stages

Stage 1: Initial information gathering

1. Input sought from broad range of sources
2. Written record made publicly available to facilitate scrutiny and further input
3. Public hearing for each immunity

Stage 2: Identification and analysis of justifications

1. Inquiry serves as a baseline screen
    a. If no justification, immunity should not be granted
    b. Immunity may have more than one justification
2. Pro-consumer justifications
    a. Immunized conduct leads to lower costs of production, distribution, or marketing
        i. Key issues to analyze
            1. What specific costs would be lowered as a result of the immunity?
            2. Would the cost savings be passed through to consumers?
            3. Is there another way to lower these costs without an antitrust immunity?
            4. Would the cost-lowering conduct create a significant risk of antitrust liability but for this immunity?
    b. Immunized conduct leads to greater benefits of production, distribution, or marketing
        i. Key issues to analyze
            1. What specific benefits would be produced as a result of the immunity?
            2. What is the value of these benefits to consumers?
            3. Is there another way to produce these benefits without an antitrust immunity?

4. But for this immunity, would the immunized conduct be illegal under the antitrust laws?

3. Justifications not related to consumer welfare
    a. Immunity leads to a socially desirable redistribution of wealth or provides a subsidy
        i. "Correction" of asymmetric bargaining power
        ii. "Ruinous competition"
        iii. Key issues to analyze
            1. What specific social goal is being achieved as a result of the immunity?
            2. Why is the immunized conduct necessary to achieve the social goal?
            3. Is there another way to achieve the social goal without an antitrust immunity?
            4. What other social goals are impacted by the immunity?
            5. But for this immunity, would the immunized conduct be illegal under the antitrust laws?
    b. Immunity promotes a socially desirable activity
        i. Key issues to analyze are the same as in section 3.a.iii., *supra*.
4. Immunity gives existing regulator complete control of all competitive issues regarding the firms it regulates
    a. Key issues to analyze
        i. What specific social goal is being achieved as a result of the immunity?
        ii. Why is the immunized conduct necessary to achieve the social goal?
        iii. Is there another way to achieve the social goal without an antitrust immunity?
        iv. What other social goals are impacted by the immunity?
        v. But for this immunity, would the immunized conduct be illegal under the antitrust laws?
        vi. Is the immunity necessary for the administrative agency to achieve its statutorily created mandate?
        vii. Is the goal of the agency the complete displacement of market outcomes or are there components of the industry at issue that would be subject to competitive conditions?

<u>Stage 3: Balancing costs and benefits</u>

1. Identify and suggest ways to measure traditional "economic" benefits and costs as well as "societal" benefits and costs
2. Ultimately, policymakers themselves have to decide how best to balance these specific costs and benefits
3. Identifying and measuring the benefits of an immunity
    a. Benefits to consumers
    b. Benefits to companies
    c. Societal benefits

For each of these three categories:

- *Identify potentially positively affected groups within the category*
- *Assign a qualitative measure of likely benefit associated with each positive effect (e.g., high vs. medium vs. low)*
- *To the extent possible, assign a quantitative measure of likely benefit associated with each positive effect (in monetary terms)*

4. Identifying and measuring the costs of an immunity
    a. Costs to consumers
    b. Costs to companies
    c. Societal costs

For each of these three categories:

- *Identify potentially negatively affected groups within the category*
- *Assign a qualitative measure of likely costs associated with each negative effect (e.g., high vs. medium vs. low)*
- *To the extent possible, assign a quantitative measure of likely costs associated with each negative effect (in monetary terms)*

5. Balancing the benefits and costs of an antitrust immunity
    a. Inherently political decision, but pro-consumer goals should weigh more heavily than general social goals
    b. Stage 3 designed as a tool to assist policymakers
6. Substantial burden on proponents to justify the immunity on cost-benefit grounds

<u>Stage 4: Tailoring the immunity to minimize anticompetitive effect</u>

1. Ruling out less restrictive or more beneficial alternatives
2. Defining scope and explicit carve-outs
3. Internal structure of joint ventures
4. Transparency in consideration of competitive concerns in regulated industries
5. Potential reporting and approval requirements

<u>Stage 5: Optional consideration for renewal</u>

1. Sunset provision terminating immunity (including every currently existing immunity) unless renewed by an affirmative act of Congress
2. If immunity considered for renewal, dynamic analysis permits policymakers to check accuracy of previous assumptions and forecasts
    a. Legislative history from previous passage of immunity documents analysis, assumptions, and forecasts
    b. New information from stakeholders

Introduction

Consistent with the strong national policy favoring competition, Congress enacted the antitrust laws intending them to apply to all areas of commerce. Since William Howard Taft's landmark decision in the *Addyston Pipe* case, courts have generally followed the sound doctrine that the Sherman Act reflects a congressional policy in favor of competition, and that it is improper for courts to "set sail on a sea of doubt" and to arrogate to themselves the power to declare "how much restraint of competition is in the public interest, and how much is not."[1] A general failure by the courts to apply the antitrust laws rigorously in response to public interest arguments that might appeal personally to judges would reflect not only unsound economic policy but also a disregard for our constitutional separation of powers.

It logically follows, however, that advocates of departures from the Sherman Act as the "Magna Carta" of the free enterprise system[2] must be free to appeal to Congress, lest judges be tempted to reject Judge Taft's teachings and take things into their own hands. In response to certain political, social, or other arguments, Congress and the President (and, on rare occasion, federal courts) have established specific immunities and exemptions from the antitrust laws that permit conduct that might otherwise create liability under these laws.[3]

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[1] *United States v. Addyston Pipe & Steel Co.,* 85 F. 271, 284 (6th Cir. 1898), *modified & aff'd*, 175 U.S. 211 (1899)

[2] *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972).

[3] A list of antitrust immunities is contained in Appendix A. Note that this report defines antitrust "immunities" broadly to include any exemption from any aspect of antitrust liability or damages. This definition includes provisions that detreble damages for antitrust violations, otherwise modify antitrust liability or damages standards, or even partially immunize certain conduct from the antitrust laws in practice despite characterizations to the contrary. *See, e.g.,* H.R. Rep. No. 96-1118, *reprinted in* 1980

It is recognized that there are obvious risks to competition policy in the legislative process. Congressionally-conferred immunities usually provide the greatest benefits to a small group of private actors or interested parties.[4] Sound public policy, however, requires that the impact of these immunities on other persons also be taken into account. Because antitrust immunities typically generate concentrated benefits and diffuse costs, there is a danger that politically sophisticated special interests will seek to enact legislation enabling them to obtain monopoly profits or otherwise protect themselves from competition, without taking into account the broader effects of reduced competition. Moreover, once created, few of these immunities ever have been eliminated. Even in cases where Congress has immunized business behavior but subjected the relevant parties to regulatory supervision, there remains a significant risk that special interests will prevail in either the legislative or administrative process to enrich themselves while pursuing non-competition policies that may seem appealing, but whose full costs may not have been comprehensively analyzed.

This Report presents a general framework to assist policymakers in framing the key issues and objectively weighing the relevant evidence and policy considerations for the purpose of determining whether to create, modify, or eliminate an immunity. In attempting to ensure this Report will be a useful policy tool for future policymakers, it was developed according to three criteria:

- *Practicality*. The framework should be useful for policymakers. Inputs should be limited to readily accessible data and other information. Application of the framework should be straightforward and relatively fast without requiring extensive technical expertise. Output should provide policymakers actionable

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U.S.C.C.A.N. 2373, at 2373 (stating that legislation exempting certain territorial restrictions in trademark licensing agreements from the antitrust laws "does not grant antitrust immunities").

[4] *See infra* note 9.

insight or analysis that will assist them in determining whether to create, modify, or eliminate the antitrust immunity at issue.

- *Transparency and analytical soundness*. The framework should promote transparent policymaking, in which both the arguments made by interested parties and the rationale for policymakers' decisions are open and accessible to the public. Further, the framework should be based upon generally accepted economic, legal, and/or other analytical principles.

- *General applicability*. The framework should be robust enough to allow policymakers to apply it to any specific antitrust immunity.

Following this introduction and an overview of the framework's key procedural safeguards, this Report details the five stages of the proposed framework. Stage 1 addresses the initial information gathering process. Actual analysis of antitrust immunities begins in Stage 2 with the clear identification and assessment of their justifications; conduct for which there is no reasonable justification or conduct with regard to which there is no significant risk of antitrust liability does not require immunizing legislation. After applying the Stage 2 screen, the costs and benefits of an antitrust immunity should be identified and balanced with as much qualitative and/or quantitative rigor as feasible. Stage 3 details these issues. The focus of Stage 4 is tailoring the scope of an immunity to minimize anticompetitive effect. Finally, Stage 5 addresses sunset provisions and regular review of immunities.

Key Procedural Safeguards

It is important for Congress to implement certain key procedural safeguards so that (A) the process is transparent and inclusive, (B) persons seeking the immunity have the burden of demonstrating the need for the immunity to minimize the scope and number of immunities promulgated, and (C) any promulgated immunity, although eligible for

renewal, is limited in duration to limit unintended consequences. For convenience, the brief descriptions immediately below provide an overview of these key procedural safeguards. More importantly, however, these procedural safeguards help shape and are described more thoroughly in the framework itself.[5]

A. Transparent and Inclusive Approach

i. Initial Information Gathering Process

Gathering information from a broad range of sources and means – including public hearings – is vital for sound policy and well-reasoned decision-making. Equally important is to make this information available to all interested parties for the purpose of identifying any errors or omissions in the record, facilitating even further input to Congress, and providing context regarding the purpose and scope of the immunity at issue.

ii. Codification of All Existing Immunities

All immunities should be codified in a single section of Title 15 of the United States Code.[6] The purpose would be to promote transparency and provide an easily accessible compilation of antitrust immunities at any given point in time.[7]

B. Burden of Proof on the Proponent of the Immunity

i. Justification for Immunity

The burden of establishing the case for any immunity should fall on the proponents of the immunity. At a minimum, the proponents should: (1) clearly explain

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[5] *See infra* pp. 7-39.

[6] Many immunities are scattered throughout various sections of Title 15 of the U.S. Code, while still others lurk in Titles 7, 16, 42, 46, 47 49, and 50.

[7] With regard to immunities affecting regulated industries, Congress may choose to enact identical statutory language that would be codified both in Title 15 as well as in the Code title of the relevant regulatory regime.

why conduct within the scope of a proposed immunity is both prohibited or unduly inhibited by antitrust liability and in the public interest; (2) make some estimation as to the effects the proposed immunity will have in addition to its intended effect; and (3) demonstrate that the proposed immunity is necessary to achieve the desired policy outcome.

ii. Balancing of Costs and Benefits

The ultimate purpose of the information gathering is to help policymakers determine whether, on whole, the proposed immunity's benefits exceed its costs. In part, the placement of the burden upon the immunity proponent is an acknowledgement that the proponent of the immunity is in the best position to articulate the benefits of the immunity.

iii. No Less Restrictive Alternative

Proponents also should bear the burden of convincing policymakers that the specific immunity proposal, in its breadth and scope, is necessary to achieve the claimed social benefits.

C. Sunset Provision Terminating Immunity Unless Renewed

i. Optional Consideration for Renewal

Unless renewed through an affirmative act of Congress, all statutorily created antitrust immunities would terminate after a set period of time. It would be up to Congress to determine whether or not to initiate a renewal process. Existing immunities should be amended to include sunset provisions and should be reviewed using the framework contained within this Report.

ii. Legislative History

If Congress opts to initiate a renewal process for a terminating immunity, the legislative history of its previous enactment would be particularly important. In that renewal process, the legislative history would provide the baseline analysis from which to compare the assumptions and conditions at the time of passage with the data obtained subsequent to passage.

Proposed Framework

I. Stage 1: Initial Information Gathering

The Stage 1 inquiry should focus upon the means by which information is obtained regarding the proposed immunity.

A. Input Sought From a Broad Range of Sources

To fully inform congressional decision-making, information regarding the immunity and its effects should be sought from a broad range of sources, including:

- *Proponents of the immunity*. As explained above, the proponents of the immunity should make the requisite demonstration, detailed herein, to justify passage of the immunity.

- *Relevant government entities*. Either the Department of Justice's Antitrust Division ("DOJ") or the Federal Trade Commission ("FTC") should provide an assessment of the effects of the proposed immunity.[8] Given their role as federal antitrust enforcement agencies, they have a unique perspective that would aid policymakers in their consideration of a proposed immunity. Where the proposal calls for immunizing conduct supervised by a federal regulatory agency, the relevant agency should also provide an assessment of the immunity's effects, with particular attention on the necessity of antitrust immunity for the agency to accomplish its regulatory mandate. Where appropriate, the views of other relevant

[8] In the past, there have been occasions when executive branch officials responsible for the Administration's position have been reluctant to allow the Antitrust Division to provide its professional expertise in cases where this advice may not fully support the President's policy agenda. If there are such occasions in the future, it will be imperative that the FTC provide the sort of independent analysis that Congress needs to assure that antitrust immunities are only enacted in the public interest after full deliberation.

government officials and entities – including state attorneys general – also should be solicited.

- *Opponents and other interested parties*.[9] Opponents of the proposed immunity and other interested parties – possibly including representatives from the affected industry as well as supplier and customer groups – should be solicited to provide initial input as well.

B. Written Record Should Be Made Publicly Available

Importantly, all formal submissions received from any party regarding the proposed immunity should be made publicly accessible[10] in order to facilitate scrutiny and further input from other members of the public, including independent researchers and scholars. Such a transparent and open approach maximizes both the diversity of viewpoints and the amount of relevant information available to policymakers in their decision-making process.[11]

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[9] By using the term "interested parties" this report does not mean to imply, as is the case in administrative law, that commentators be limited by notions such as standing or other measures designed to limit participation. It is recognized, however, that it is impracticable to allow all-comers to submit comments. *See Bi-Metallic Inv. Co. v. State Bd. Of Equalization*, 239 U.S. 441, 445 (1915). Rather, it is more important that all stakeholders are represented than it is that all persons are represented. Thus, consumer groups, academics (from a broad range of perspectives), supplier groups, labor representatives, community representatives, and other stakeholders should have sufficient representation in order to communicate their diverse viewpoints.

[10] Information should be made accessible in numerous ways. The method that provides the highest degree of accessibility is making all materials submitted to Congress available on the internet. Additionally, comments could be published in a fashion similar to the publication model utilized for committee hearings.

[11] Congress has routinely required transparency in the promotion of sound decision making. *See* 5 U.S.C. § 553 (notice and comment rulemaking). *See also* KENNETH CULP DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY 113-14 (1971) (arguing that public scrutiny protects against arbitrary decision-making by administrative agencies). In the realm of antitrust law, Congress has provided mechanisms to ensure sound decision making and openness. *See* 15 U.S.C. § 16(b)-(h) (The Tunney Act, providing for public comment and public interest review by a court regarding consent decrees).

There are multiple benefits to a transparent decision-making process. First, a transparent process aids in the ability of a decision-maker to obtain complete and accurate information by enabling observers of the process to critique, comment, and correct information submitted before the decision-making entity. Secondly, transparency helps to ensure reasoned decision-making by providing observers with means to argue persuasively before a decision-maker and to provide policy rationales in opposition to or in favor of proposed legislation. These two related benefits of transparency provide "sunlight" to the decision-making process. *See* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 62 (1933) ("Sunlight . . . is said to be the best of disinfectants; electric light the most efficient policeman.").

C. Public Hearing

The goal of this initial information gathering is to allow legislators to determine if the proposed immunity has sufficient merit to warrant serious consideration. To ensure that any enacted immunity is passed based upon a fully-informed legislative process, the relevant committee or subcommittee should subject proposed immunities – whether in the form of stand-alone legislation or of an amendment to another bill – to the scrutiny of a hearing to clarify the positions and arguments of interested parties.

II. Stage 2: Identification and Analysis of Justifications

The Stage 2 inquiry should focus on why the conduct covered by a proposed immunity serves the public interest and why an antitrust immunity is needed to facilitate this conduct. If no justifications can be proffered, the immunity should not be granted. Thus, Stage 2 serves as a baseline screen.

Although immunized conduct may have multiple justifications, this stage addresses three categories of justifications separately:

- *Pro-consumer justifications*. Justifications in this category are based upon a legislative determination that the immunized conduct would enhance consumer welfare. While proponents of the proposed immunity would be expected to benefit from the immunity, their welfare is not at issue under this type of justification. Instead, the question is whether the immunized conduct would lead to lower prices or improved product quality for consumers. It should be noted that the "immunity" being sought is immunity from the antitrust laws which were designed to promote consumer welfare. Thus, a valid pro-consumer justification for an immunity from these very laws would likely be limited to cases where the conduct in question may create antitrust liability under existing antitrust statutes and case law even though research and experience has demonstrated that conduct to be pro-consumer. Such situations are likely to be the exception, not the rule.

- *Justifications not related to consumer welfare*. Although the Sherman Act has been aptly called the "Magna Carta of our free enterprise system," our democratically elected representatives have a very wide berth under our Constitution to make social and political judgments about the extent to which competition is in the public interest. Moreover, if courts are to strictly adhere to the Supreme Court's admonition that the antitrust laws permit no defense that competition is unreasonable, those who feel aggrieved by the application of the antitrust laws must be able to seek recourse from their elected representatives. For justifications involving social goals that are not related to consumer welfare, it is important to be mindful of the tradeoffs between these social goals and the goal of consumer welfare. In addition, there may be tradeoffs between social goals that the immunized conduct would help achieve, on the one hand, and other social goals, on the other. How to evaluate these tradeoffs is considered in more detail in Stage 3.

- *Giving an existing regulator complete control of all competitive issues regarding the firms it regulates*. The sub-categories of justifications for immunizing from antitrust liability conduct subject to regulation include the following: (1) the regulators, rather than Congress, should balance the goal of consumer welfare against other social goals; (2) regulators, rather than the judicial process, should determine whether certain conduct within a particular industry is procompetitive or anticompetitive; or (3) the existence of antitrust laws somehow precludes the desired results of regulation. Opponents of these immunities, however, point out that regulators both are susceptible to "capture" by the industries they are supposed to be regulating[12] and do not have the expertise analyzing antitrust issues possessed by antitrust enforcers (*e.g.*, DOJ and FTC).

At least one justification should apply to a proposed immunity. If no justification applies – including situations in which the conduct at issue would be lawful under the antirust laws in any event – the immunity should not be granted.

A. Pro-Consumer Justifications

1. Immunized Conduct Leads to Lower Costs of Production, Distribution, or Marketing

[12] *See* THE POLITICS OF REGULATION, (James Q. Wilson ed., 1980); W. KIP VISCUSI, JOHN M. VERNON, & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 44-45 (3d ed. 2000).

The immunity might be justified if the immunized conduct would lead to lower costs of production, distribution, or marketing for the immunized firms, and these lower costs would be passed through to consumers in the form of lower prices. For example, consider a group of rival firms that want to form a joint venture to manufacture an input that they all use at lower cost. The joint venture's cost of manufacturing the input would be lower than the price for the input charged by existing third-party suppliers. While the lower costs, if passed through to consumers, would appear to enhance consumer welfare, the firms may seek an antitrust immunity if the extent of their joint conduct in their particular market would expose them to antitrust liability.

This justification has been offered for several existing immunities, such as the National Cooperative Research and Production Act.[13] The argument for this act is that it limits liability for potentially illegal joint action by rival firms that produces cost reductions.

The key issue to analyze with respect to this justification is the relationship between the immunized conduct and the final price paid by consumers. What specific costs would be lowered as a result of the immunity? Would the cost savings be passed through to consumers? Is there another way to lower these costs without an antitrust immunity? Would the cost-lowering conduct create a significant risk of antitrust liability but for this immunity?

2. Immunized Conduct Leads to Greater Benefits in Terms of Product Characteristics, Distribution, or Marketing

The immunity might be justified if the immunized conduct would lead to new products, higher quality products, wider distribution, or more effective promotion. For

[13] 15 U.S.C. §§ 4301-06.

example, consider a group of rival fax machine manufacturers who want to reach agreement on a standard for interconnection of their next generation products. With interconnection possible, demand for these next generation fax machines would increase (this is an example of "network externalities"; in contrast, if the manufacturers' fax machines could not interconnect with each other, there would be significantly reduced value from owning a fax machine).[14] In other words, the value of the products to consumers might increase if interconnection were possible. While the interconnection agreement would appear to enhance consumer welfare, the firms may seek an antitrust immunity if they fear antitrust intervention by the federal agencies or third parties.

This is a justification offered for several existing immunities, such as the Standards Development Organization Advancement Act.[15] The argument for this act is that it limits liability for potentially illegal joint action by rival firms that improves product quality due to network externalities and other reasons.

The key issue to analyze with respect to this justification is the relationship between the immunized conduct and the benefit in terms of new products, higher quality products, wider distribution, or more effective promotion. What specific benefits would be produced as a result of the immunity? What is the value of these benefits to consumers? Is there another way to produce these benefits without an antitrust immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

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[14] A product exhibits a network externality when the value to a consumer of using the product increases with the number of other consumers also using the product. A fax machine has little value to a person unless other people also have (compatible) fax machines.

[15] 15 U.S.C. §§ 4301-05, 4301 note.

B. Justifications Not Related to Consumer Welfare

1. The Immunity Creates a Socially Desirable Redistribution of Wealth or Provides a Subsidy

The immunity might be justified as providing a subsidy to one group, or as promoting a redistribution of wealth from one group to another in a way that is viewed to be socially desirable.

One example of this type of justification involves the "correction" of asymmetric bargaining power. This is a justification offered for several existing immunities, such as the Capper-Volstead Act.[16] The argument is that this immunity enables small entities alleged to have little individual bargaining power (*e.g.*, farmers) to group together to negotiate jointly with single large entities alleged to have substantial bargaining power (*e.g.*, supermarket chains). In this situation, proponents may be able to demonstrate that a socially desirable wealth transfer from the larger to smaller entities may occur. Such a transfer may also have macroeconomic benefits (*e.g.*, one argument for the labor exemption is that conferring power on unions increases worker purchasing power). It should be noted, however, that in addition to the socially desirable wealth transfer, there may be (unintended) anti-consumer consequences of changes in bargaining power.[17]

Another example of the "redistribution of wealth" justification involves the preservation of firms that would otherwise go out of business. In the past, this has often been referred to as the "ruinous competition" justification.[18] For example, if firms in an

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[16] 7 U.S.C. §§ 291-92.

[17] This possibility is discussed in Stage 3. *See infra* Section III.

[18] The notion of ruinous competition has an extensive history. *See* Herbert Hovenkamp, *The Antitrust Movement and the Rise of Industrial Organization,* 68 Texas L. Rev. 105, 131-144 (1989). Under common law antitrust applications prior to the passage of the Sherman Act, ruinous competition was successfully used as a defense. *See, e.g.*, *Morgan v. New Orleans, M. & T.R.R.*, 17 F. Cas. 754, 758 (C.C.D. La. 1876) (No. 9804); *Nutter v. Wheeler*, 18 F. Cas. 497 (D. Mass. 1874) (No. 10,384). Merger

industry are allowed to set prices jointly, free from antitrust liability, they may be able to price at a level that allows them all to stay in business, whereas if competition were allowed to prevail the least efficient firms would be forced out of business. Immunizing joint price setting amounts to a transfer of wealth from consumers (who end up paying higher prices) to the firms. This is a justification offered for the Shipping Act,[19] which allows ocean common carriers to set prices jointly. Economists have long argued that keeping firms in business is not a valid justification as far as economic efficiency is concerned.[20] Thus, if an immunity allowing price-fixing is to be justified, it must be on the basis that the wealth transfer in question is otherwise socially desirable, either as a matter of congressional views on a just distribution, or based on non-competition policies such as the preservation of jobs in a particular region or the need to protect specified creditors or shareholders.

The key issue to analyze with respect to the redistribution-of-wealth justification is the tradeoff between the social goal achieved by the immunity and other economic or social goals. What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an antitrust immunity? What other social goals

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to monopoly was allowed based upon an assertion of ruinous competition. *See, e.g., Barr v. Pittsburgh Plate Glass Co.*, 51 F. 33, 40 (C.C.W.D. Pa. 1892) (No. 22); *Diamond Match Co. v. Roeber*, 13 N.E. 419, 421 (N.Y. 1887); *Lumbermen's Trust Co. v. Title Ins. & Inv. Co. of Tacoma*, 248 F. 212, 217 (9th Cir. 1918).

As a defense, the notion of "ruinous competition" has not fared as well post-Sherman Act. *See* Hovenkamp, *supra*, at 133. This is in part due to the passage of the Sherman Act itself as well as more sophisticated microeconomic theory explaining the efficiency of entry and exit from markets in most circumstances. *See United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *United States v. Addyston Pipe & Steel Co.*, 78 F. 712, 715 (C.C.E.D. Tenn. 1897), *rev'd*, 85 F. 271 (6th Cir. 1898), *modified & aff'd*, 175 U.S. 211 (1899); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

[19] 46 U.S.C. app. §§ 1701-19.

[20] *See, e.g.*, F. SCHERER AND D. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 296 (3d ed. 1990).

are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

2. Immunity Promotes a Socially Desirable Activity

The immunity might be justified on the basis that it promotes an activity that is deemed to be socially desirable for reasons apart from enhancing consumer welfare. This is a possible justification for the Newspapers Preservation Act,[21] which is purported to preserve diverse "points of view" for news while allowing monopoly pricing of newspapers and advertising to be shared between newspapers.

Some activities may promote total welfare (the sum of producer and consumer welfare) at the expense of consumer welfare. For example, collaboration between two competitors might allow them to avoid duplicating significant fixed costs, while at the same time leading to higher prices for consumers. It is possible that the fixed cost savings would outweigh the higher consumer prices, leading to an overall increase in total welfare. These types of activities may create antitrust liability under existing antitrust law. Producers might therefore seek antitrust immunity on the grounds that such activities are socially desirable because they improve economic efficiency and total welfare.

As with immunities providing a redistribution of wealth, the key issue to analyze with respect to this justification is the tradeoff between the social goal achieved by the immunity and other economic or social goals. What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an

[21] 15 U.S.C. §§ 1801-04.

antitrust immunity? What other social goals are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

C. Immunity Gives Existing Regulator Complete Control of all Competitive Issues Regarding the Firms it Regulates

An immunity may be justified when a regulatory agency has been expressly empowered by Congress to displace market outcomes in an industry. Congress may expressly confer upon the regulator the exclusive power to control competitive issues within that industry by providing the industry with antitrust immunity.[22]

The basic approach toward immunities for regulated industries should be the same as any other antitrust immunity. The burden should be on those who seek to immunize regulated conduct from the antitrust laws to demonstrate persuasively why Congress should expressly immunize conduct approved by a regulator from the antitrust laws. As with other immunities, Congress should draft the statutory provision to precisely identify its scope: that is, to precisely identify the conduct that will be exempt from antitrust scrutiny.[23] The proposed framework also seeks to minimize if not eliminate such issues as to the scope of an express immunity by requiring that a detailed legislative history accompany any statutory immunity. Finally, this approach should, to a significant degree, avoid questions regarding implied immunities for regulatory behavior.

Where Congress contemplates an antitrust immunity in a regulated industry, it is important that the FTC or DOJ be the principal agency responsible for determining the

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[22] *See, e.g.,* 49 U.S.C. § 10706 (Rail transportation exemption).

[23] Careful drafting is crucially important because even when Congress appears to be clear, controversy over the scope of an express immunity can arise around the periphery of the immunity. For example, the Congressional exemption from federal antitrust regulation for the insurance industry under the McCarran-Ferguson Act is expressly limited to "the business of insurance" is only available to the extent the conduct in question is regulated by state law, and is further limited by a proviso excepting from the exemption conduct amounting to a "boycott", "coercion" or "intimidation." Controversy has occurred about the meaning of each of these limitations upon the scope of the express exemption.

competitive effect of challenged conduct, and that determination ought to be binding upon the regulatory commission. In addition, current regulatory regimes should be reviewed by Congress to clarify any ambiguity concerning the extent to which regulated conduct should be immune, and henceforth conduct should be subject to the antitrust laws unless expressly immunized. This approach is consistent with the process utilized in consideration of renewal of any immunity.

As with all justifications unrelated to consumer welfare, the key issues are: What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an antitrust immunity? What other social goals are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws? Additional queries that might be useful in the context of regulation are: Is the immunity necessary for the administrative agency to achieve its statutorily created mandate? Is the goal of the agency the complete displacement of market outcomes or are there components of the industry at issue that would be subject to competitive conditions?

III. Stage 3: Balancing Costs and Benefits

A. Usefulness of Explicitly Considering Costs and Benefits

Sound decision-making requires that the consequences of each alternative be evaluated. This is true of decisions in areas ranging from mundane personal matters (*e.g.*, what to have for dinner) to business strategy (*e.g.*, where to invest R&D funds) and government policy (*e.g.*, what regulations to implement). In general, the decision-maker

should first identify all positive consequences ("benefits") and all negative consequences ("costs") of each potential action and then should compare the benefits to the costs. The "net benefit" from each potential action would equal the benefits less the costs.

Academicians have endorsed this approach in the literature on decision-making.[24] In addition, economists have used "cost-benefit analysis" for over 50 years to analyze government policy decisions.[25] The approach has also been adopted by the Executive Branch, which has required administrative agencies to use cost-benefit analysis in the promulgation of rulemaking.[26]

While formal cost-benefit analysis requiring quantification and extensive detailing of costs and benefits may be too time-consuming and potentially infeasible in the analysis of antitrust immunities, the general approach set forth in Stage 3 – generally identifying and assessing the costs and benefits to the extent possible – is consistent with more rigorous analysis. Although each immunity is different and thus requires a discussion of different facts and circumstances, the approach set forth in this stage is general enough to accommodate virtually any fact set that may arise in a given circumstance.

Besides its generality and acceptance in other areas, cost-benefit analysis offers other advantages as a methodology. Perhaps most importantly, it requires proponents, opponents, and neutral parties (including decision-makers) to completely identify and evaluate the full set of benefits and costs that the proposed immunity is expected to

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[24] *See, e.g.,* R. KEENEY AND H. RAIFFA, DECISIONS WITH MULTIPLE OBJECTIVES: PREFERENCES AND VALUE TRADEOFFS (1993).

[25] *See, e.g.,* E. MISHAN, COST BENEFIT ANALYSIS (1971).

[26] *See* Exec. Order No. 12,866, 3 C.F.R. 638 (1993-2000), *reprinted as amended in* 5 U.S.C. § 601 note. Executive Order 12,866 replaced Executive Order 12,291 which also required, to the extent permitted by law, the consideration of costs and benefits in the promulgation of regulations. *See* Exec. Order No. 12,291, 3 C.F.R. 128 (1981-93).

generate. The complete weighing of costs and benefits based upon full and complete information promotes good decision-making and increases the likelihood that only immunities Congress determines to be socially beneficial will be granted.

By using cost-benefit analysis, Congress will promote increased transparency into the rationale for conferring the immunity. Stage 3 analysis requires that the costs and benefits of a proposed immunity be explicitly identified and weighed against each other, assisting policymakers in reaching an informed conclusion regarding the proposed immunity. Outsiders to the decision-making process will be able to understand which benefits and costs were considered and how they were weighed in order to come up with the final determination.

One criticism often leveled at formal cost-benefit analysis is that it asks for too much – that it is not possible to quantify precisely all of the benefits and costs associated with a proposed action. As demonstrated in this stage, however, it is not necessary to quantify every benefit and cost to produce a useful analysis – the process of explicitly identifying all the types of costs and benefits is valuable in its own right. Moreover, a decision should be made with the list of costs and benefits in mind, even if they cannot be quantified.

B. Summary of Stage 3

This stage identifies and suggests ways to measure traditional "economic" benefits and costs as well as "societal" benefits and costs. Ultimately, however, policymakers themselves have to decide how best to balance these specific costs and benefits.

The economic benefits and costs of a proposed immunity will generally affect three groups: consumers, companies advocating for the immunity, and other companies (*e.g.*, rivals and suppliers). Generally speaking, consumers will be affected to the extent the proposed immunity changes price, quality, or the set of consumer choices. As discussed in Stage 2, business conduct may be pro-consumer, and consumers benefit to the extent that the proposed immunity promotes such conduct. On the other hand, the immunity may decrease consumer welfare if it allows conduct that is anti-consumer, such as price-fixing. Indeed, given that immunity from the antitrust laws is sought, the *prima facie* case will often be one where consumer harm is expected to result from the immunity.[27] When an immunity is proposed for conduct subject to government regulation, the analysis must consider the regulatory scheme to determine if it is likely to result in the authorization of anti-consumer conduct. Some conduct within the scope of proposed immunities may simultaneously increase the welfare of some consumers and reduce the welfare of others. This too should be considered in the cost-benefit analysis.

Companies are divided into two groups: proponents of the proposed immunity and other companies. The proponents of the proposed immunity presumably would be expected to benefit from the immunity in the form of greater profits (otherwise they would not be seeking the immunity). Other companies may benefit or may be harmed. For example, companies who are customers of the immunized companies might benefit if the immunized conduct lowered the costs and prices of the immunized companies, but

[27] For example, if the conduct proposed to be immunized from the antitrust laws involves naked price fixing or horizontal market allocations (typically *per se* illegal conduct under the antitrust laws), then consumers would likely face price increases or reductions in output due to the conduct for which immunization is sought. In contrast, vertical collaborations would be less likely to injure consumers, but also less likely to violate the antitrust laws. Thus, proponents of an antitrust immunity would have a stronger argument for their need for the immunity if the conduct is likely to violate the antitrust laws.

might be harmed if the immunized conduct allowed price-fixing by the immunized companies.

In addition to the economic benefits and costs, there may also be "societal" benefits and costs related to other social goals Congress might deem to be important, such as the redistribution of wealth.

The following sections offer an approach to identifying the potential benefits and costs and suggest methods by which these benefits and costs might be measured. The basic approach is as follows: (1) identifying of the groups potentially benefited or harmed by the proposed immunity; (2) identifying of the types of benefit or harm that each such group would receive; (3) performing a qualitative assessment of the expected magnitude of each category of benefit or harm should be made;[28] and (4) wherever possible, performing a quantitative assessment of the expected magnitude of each benefit or harm. In many cases, as described more fully below, a first order approximation may be possible using available industry information and existing economic literature.

C. Identifying and Measuring Benefits

1. Benefits to Consumers

A proposed immunity will potentially benefit consumers if it would decrease prices or improve product quality. For example, if the immunized conduct led to lower costs for producers that were then passed onto consumers, consumers would benefit from the lower prices. Similarly, if the immunized conduct led to improved product quality or the introduction of new products that would otherwise not have been introduced, consumers benefit from the increased product quality and variety.

[28] This Report suggests a "high," "medium," or "low" grade be assigned to each category of benefit or harm.

The first step in the analysis is to identify groups of consumers who might benefit from the immunity. Three potential groups are: (1) any consumers who directly purchase the products of immunized companies, who are potentially the primary beneficiaries of the pro-consumer effects of the immunity; (2) the consumers of final products for which the immunized product is an input, who could benefit to the extent that cost-savings were passed through to final consumers or the quality of the final product improved;[29] and (3) consumers of substitute products for the immunized companies' products, who might benefit if increased competition from the immunized companies forced companies selling substitute products to decrease their prices or improve their product quality.

The next step in the analysis is to make a qualitative assessment of the expected benefit associated with each potential positive effect of the immunity. This Report proposes assigning each potential positive effect a score of "high," "medium," or "low" depending on the magnitude of the potential effect and the likelihood of it occurring. A checklist of industry characteristics might be useful in making this assessment. For example, for an industry producing products for which no close substitutes exist, the benefits on consumers of substitute products would be expected to be negligible.

Ideally, it would also be valuable to make a quantitative assessment of the expected benefits. This would generally be considerably easier when re-assessing an existing immunity than when assessing a proposed immunity. For example, a comparison of prices before and after the immunity was granted (properly controlling for changes in other economic factors) would provide an estimate of the effect of the immunity on prices.

[29] This would be important in cases where the products of the immunized companies are often not directly purchased by consumers, but instead are used as inputs into the production of some final product.

However, quantitative assessments may still be possible when analyzing some proposed immunities. Some basic information may be readily available that would allow for calculations of the benefits to be performed. For example, if the proposed immunity would decrease producer costs by $1, it might be reasonable in certain circumstances to assume that this cost decrease would be passed through one-for-one to consumers. A first approximation of the benefits to consumers would equal the $1 price reduction multiplied by the number of unit sales.

Another approach to assessing the benefits to consumers of a proposed new immunity would involve referring to estimates of related consumer benefits that appear in the economic literature. For example, this Report provides several "case studies" illustrating how rough calculations of the benefits to be performed could be achieved in a situation where basic information was available.

In the first case, suppose that the proposed immunity would lead to lower producer costs. Two questions arise when analyzing the consumer benefits in this situation. First, how much of the producer cost decrease would be passed through to the prices that consumers pay? Second, how much would consumers benefit from the lower prices?

> **Case Study:** The pass-through of the cost decrease resulting from the proposed immunity to consumer prices could be approximated either by reference to the pass-through that has been observed in a comparable industry or by applying what is known in the economic literature about the relationship between pass-through and industry characteristics to the industry at issue.[30] Once the extent to which consumer prices would be

[30] *See, e.g.*, J. Hausman and G. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON L. REV. 707 (1999) (discussing industry characteristics that influence the extent of pass-through); T. Besley & H. Rosen, *Sales Taxes and Prices: An Empirical Analysis*, 52 NAT'L TAX J. 157 (1999) (studying the extent of pass-through of taxes in various retail industries); D. Besanko, J. Dube, & S. Gupta, *Own Brand and Cross Brand Pass-Through,* 24 MARKETING SCI. 123 (2005) (same); A. Gron and D. Swenson, *Cost*

lower has been estimated, the value to consumers of the lower prices is a straightforward approximation based on existing unit sales, the existing price, the expected price decrease, and the expected unit sales increase.[31] The expected unit sales increase can itself be estimated based on an assessment of the price sensitivity of the demand for the product.

Turning to the case where the proposed immunity would involve the introduction of a new product, the key question is how much consumers would value the new product. This value could be estimated by calibrating the product at issue to a comparable product for which the value to consumers has been estimated in the literature on new product introductions.[32] If the proposed immunity would lead to a new product introduction, the associated value to consumers could be estimated by benchmarking off of similar products for which the value to consumers has been estimated in the literature.

Case Study: Suppose that a proposed immunity would allow a group of producers to introduce a new service that would compete with direct broadcast satellite and cable TV. The gains to consumers that would result from the introduction of this new service could be estimated using an appropriate calibration to the consumer gains from direct broadcast satellite that were estimated by Goolsbee and Petrin.[33]

In the case where the proposed immunity would increase the quality of an existing product, the economic literature may contain estimates of the value to consumers of the relevant dimension of product quality. These estimates could be used to assess the value

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Pass-Through in the US Automobile Market, 82 REV. OF ECON. & STAT. 316 (2000) (discussing pass-through in the automobile industry).

[31] *See, e.g.*, J. PERLOFF AND D. CARLTON, MODERN INDUSTRIAL ORGANIZATION 70-72 (4th ed. 2005) (discussing consumer welfare calculations).

[32] *See, e.g.*, J. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition, in* THE ECONOMICS OF NEW GOODS (R. Gordon & T. Bresnahan eds., 1997); A. Petrin, *Quantifying the Benefits of New Products: The Case of the Minivan*, 110 J. POL. ECON. 705 (2002); J. Hausman and G. Leonard, *The Competitive Effects of a New Product Introduction: A Case Study*, 50 J. INDUS. ECON. 237 (2002); A. Goolsbee and A. Petrin, *The Consumer Gains From Direct Broadcast Satellites and the Competition With Cable TV*, 72 ECONOMETRICA 351 (2004).

[33] Goolsbee & Petrin, *supra* note 32.

to consumers of immunized conduct that would further improve this dimension of product quality.

> **Case Study:** Suppose a proposed immunity would allow automobile manufacturers to collaborate on the development of a new engine technology that would improve fuel efficiency. One approach to estimating the value consumers would place on vehicles with greater fuel efficiency would be to rely on existing economic studies that have studied the demand for automobiles.[34] These studies provide an estimate of the amount that consumers would be willing to pay for increased miles per gallon, from which the consumer value of improved fuel efficiency can be determined.

2. Benefits to Companies

The primary beneficiaries of antitrust immunity are likely to be the proponents. However, other companies may benefit as well. The first step in the analysis is to identify the companies that would likely benefit. In addition to the proponents, other companies that might benefit are: other companies in the same distribution chain as the immunized companies, companies that produce complementary products,[35] and companies that sell substitute products.[36]

If the immunity has pro-consumer (price-decreasing or quality-improving) effects, it would be expected to benefit other companies in the distribution chain and companies that make complementary products. To the extent that the immunity decreases the price or improves the quality of the immunized companies' products, the demand for these products should increase and thus the demand for the other companies' (complementary)

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[34] An example of such a study is S. Berry, J. Levinsohn, and A. Pakes, *Automobile Prices in Market Equilibrium*, 63 ECONOMETRICA 841 (1995).

[35] "Complementary products" are those where the demand for one product or service is positively related to the demand for another product or service. For example, shoes and shoelaces are complementary. Similarly, computer hardware and software are complementary.

[36] "Substitute products" are those where the demand for one product is negatively related to the demand for the other. For example, Coke and Pepsi are substitute products.

products should increase as well. For example, a distributor selling the products of the immunized companies would likely sell more units if those products were of higher quality.

Companies that sell substitute products, on the other hand, would generally be expected to benefit from the immunity only if the immunity had anti-consumer effects (*i.e.*, led to higher prices or lower quality). For example, if the immunity led to price-fixing among the immunized companies, companies selling substitute products might be able to raise their prices as well.

As with consumers, this Report proposes that the magnitude of each potential benefit to companies be qualitatively assessed with a high/medium/low rating. Again, a checklist of industry characteristics may help in making this assessment. For example, in an industry where promotion is an important driver of consumer demand, but free-riding by one distributor on another's promotional efforts is a serious danger, an immunized vertical restraint may provide significant benefits to the manufacturers and even to the distributors of the product.

This Report also proposes that a quantitative assessment of the benefits be made whenever possible. As with consumers, measurement of the benefits of an existing immunity may be feasible by comparing the effects of the immunity to the state of the industry prior to passage of the immunity. In cases where a new immunity is being considered, the necessary information may be available to make first approximation calculations of the benefits.

> **Case Study:** Consider an immunity that would lead to increased sales by the immunized firms. Of interest would be the benefits to the producers of complementary products. In certain situations, a complementary product may sell in roughly a fixed proportion to the product sold by the immunized

companies. For example, a company selling a cellular phone accessory such as a leather case may sell one leather case for every 10 cell phones sold. Given knowledge of the likely increased demand for the product of the immunized firms (which can be estimated using the methods described in the consumer benefit section above), one could apply the fixed proportion to determine the likely increased demand for the complementary product. The benefits to the producers of these products would equal the additional profit they would make on the additional sales.

Case Study: Suppose a proposed immunity would allow a group of producers to engage in retail price maintenance. The retail price maintenance would prevent price competition among retailers, but encourage the provision of service and promotion by retailers. Existing economic literature may provide a useful guide on the effects of retail price maintenance on the profitability of producers and retailers.[37]

3. Societal Benefits

There may be benefits of the immunized conduct that redound to parties other than consumers and companies. These benefits can be referred to as "societal" benefits. For example, an immunity that ensured that a certain resource would be available in a national defense emergency would presumably benefit all of society. As another example, an immunity that led to increased charitable activity would benefit recipients of the charitable funds. It may also be the case that the immunized conduct has redistributive or other effects that Congress views as beneficial.

All such claimed benefits should be identified and then assessed in qualitative terms using the high/medium/low rating. Industry facts may be useful in making this assessment. For example, a national defense benefit would not be expected to be very large if there were a substitute resource that would be readily available.

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[37] *See, e.g.,* S. Ornstein and D. Hanssens, *Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States*, 36 J. INDUS. ECON. 1 (1987); T. OVERSTREET, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE, FTC BUREAU OF ECONOMICS STAFF REPORT (1983); P. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. L. & ECON. 263 (1991).

Ideally, these societal benefits should also be quantitatively assessed so that they can be compared to other benefits and costs of the proposed immunity. This is generally more difficult to do than the assessment of the benefits to consumers and companies.

> **Case Study:** Consider a small group of regulated firms seeking both regulatory approval and antitrust immunity to fix higher prices for a service they currently provide to a subset of the population. The justification is that the higher prices on customers who purchase the service would be used to cross-subsidize provision of the service to all consumers ("universal service"). Universal service might be argued to provide a desirable redistribution of wealth. The relative effectiveness of this form of redistribution might be assessed by comparing it to other redistributive programs in terms of the ratio of amount of income redistributed to the deadweight loss created; an effective program is one that has a high ratio.

D. Identifying and Measuring the Costs of an Immunity

1. Costs to Consumers

The approach to measuring the costs associated with immunity mirrors the approach used to measure benefits. The analysis of costs will, in many respects, be the opposite side of the benefits coin. For consumers, costs of the immunity might include higher prices, lower quality, or reduced consumer choice, for example.

The first step in the analysis of costs is to identify the groups of consumers that would potentially be adversely affected by the immunized conduct. The primary groups of consumers expected to be affected are: (1) direct consumers of the immunized companies' products, (2) indirect consumers of the immunized companies' product, and (3) consumers of substitute products.

If the immunized conduct would lead to price increases or quality reductions for the products of the immunized firms (due, *e.g.*, to immunized price-fixing), direct and indirect consumers of these products would likely be harmed. In addition, consumers of products that are substitutes for the products of the immunized companies would also

likely be adversely affected. The producers of these substitute products, while not immunized from price-fixing, might be able to increase their prices due to the decreased competition from the immunized companies.[38]

As with benefits, this Report proposes that a qualitative analysis first be applied in order to identify the potential costs that are of the largest magnitude and have the highest likelihood of occurring. A checklist of industry factors may again be useful in making this assessment. For example, in the case of an industry producing products that have no close substitutes, the potential for harm to consumers due to price-fixing by the immunized firm may be deemed "high."

Ideally, the likely costs to consumers would be measurable and thus quantifiable. For an existing immunity that is being reviewed, an analysis of historical data may prove to be useful for purposes of quantitative analysis. For proposed immunities, basic information may be available that would allow a first approximation to be calculated.

> **Case Study:** Suppose a proposed immunity would allow firms to engage in price-fixing. In this case, it would be useful to analyze the likely costs to consumers from higher prices. The first question that needs to be answered is how much higher prices are likely to be. For example, knowledge of the industry, elasticity of demand,[39] and company profit margins might allow one to predict the price increase that would result from price-fixing to first approximation. Alternatively, the economic literature may also be able to provide some useful guidance. For example, a recent academic study has determined that the average cartel overcharge tends to be 49% over the competitive price level.[40] This may provide a useful starting point for analyzing the negative effects on

[38] For example, if the immunized producers raised their prices, the demand faced by producers of substitute products would increase as some customers attempted to switch from the products of the immunized producers to substitute products. Faced with increased demand, the producers of substitute products would generally have the incentive to increase their prices at least somewhat. This is an indirect effect of the immunity.

[39] The industry elasticity of demand is a measure of the sensitivity of the demand of customers to an increase in the prices of all of the firms in the industry.

[40] John M. Connor & Robert H. Lande, *Optimal Cartel Fines*, TUL. L. REV. (forthcoming) (draft at Section III.B., on file with authors).

consumers of an immunity that would allow companies to jointly set their prices.

Case Study: Returning to the regulated firm case study[41], consumers of the service (who would have purchased it in the absence of universal service) would face higher prices as a result of the immunity. The resulting reduction in consumer welfare could be estimated as described in the previous case study.

2. Costs to Companies

Companies adversely affected by an immunity would include: (1) competitors of the immunized companies, (2) companies in the distribution chain, and (3) companies selling complementary products. Competitors of the immunized companies may be harmed in two ways. First, the competitor would be harmed if the immunity allows the immunized companies to exclude it from the market. For example, an immunity might allow the immunized firms to impose exclusive dealing arrangements on customers. Second, if the immunized conduct is pro-consumer, competitors of the immunized firms could be harmed simply due to the greater competition they will face from the immunized companies (through lower prices or higher quality products).

Companies in the distribution chain (*i.e.*, companies who supply the immunized companies or companies who purchase from the immunized companies) will be harmed if the immunity makes the immunized companies less competitive. For example, if the immunized companies raise their prices or reduce their product quality, companies who supply to or purchase from the immunized companies will make fewer sales themselves and thus make lower profits. Companies in the distribution chain may also be harmed if the immunized conduct causes them to be foreclosed from purchasing from or selling to the immunized companies.

[41] *See supra* Section III.C.3.

Companies who sell complementary products will be harmed if the immunity makes the immunized companies less competitive. Fewer sales of the immunized companies' products typically mean fewer sales for sellers of complementary products as well.

Having identified the groups of companies that might be harmed by the immunity, the next step is to assign a high/medium/low rating to each group. Again, a checklist of industry characteristics might be useful. For example, the harm to an excluded company would not be expected to be large if the company was in a competitive industry; in that case, its economic profits would be negligible and thus its losses if it were excluded would be relatively small.

Where possible, a quantitative analysis of the costs to companies should also be performed. For example, the profits of firms that are at risk of being excluded from the market could be calculated. As another example, a distributor's loss in profits from the loss in sales of the immunized companies' products could be calculated.

> **Case Study:** Suppose a proposed immunity would allow incumbent telecommunications firms to exclude a potential entrant to the market. The business plans of the potential entrant may provide a reasonable estimate of the entrant's likely profits if entry had not been prevented. The costs to the entrant of the immunity would be equal to the profits it would have made absent the immunity.

> **Case Study:** Suppose a proposed immunity would lead to a reduction in the immunized companies' sales. A distributor whose business included the distribution of the immunized companies' sales would likely suffer a reduction in its own sales as a result of the immunity. The distributor would lose profits based on the lost sales. The lost profits would represent a measure of the cost of the immunity to the distributor.

Economic literature on the likely costs of the conduct in question may also be useful. For example, in the case of a vertical restraint that may be immunized, economic literature exists on the effects of such restraints on distributors.

3. Societal Costs

The immunized conduct may have negative impacts on society aside from the effects on consumers and companies. For example, the immunized conduct may lead to a redistribution of wealth. To the extent Congress believes distribution impacts are important, the affected groups and the extent of the redistribution caused by the immunity should be identified and assessed qualitatively or quantitatively.

E. Balancing the Costs and Benefits of an Antitrust Immunity

The proposed analysis identifies specific costs and benefits and, where possible, quantifies them. Quantified costs can be subtracted from quantified benefits to arithmetically derive a "net quantified benefit" for the immunity. Members of Congress are then well-situated to reach an ultimate conclusion as to whether or not the proposed immunity serves the public interest. Obviously, legislators may differ as to the weight to be given to any particular cost or benefit.[42] Alternatively, legislators may prefer not to simply engage in addition, giving more weight to a cost or benefit that substantially affects some of their constituents and less weight to one that may only slightly affect many. These inherently political decisions regarding balancing costs and benefits are for elected representatives to make; the objective of this framework is simply to provide the tools for making these political decisions in an informed and transparent context.

[42] Indeed, even what should count as a cost or benefit is open to interpretation. For example, some may consider increased consumer prices affecting many of their constituents to be costs, while others may view higher prices as costly only to the extent that some consumers make less-efficient purchases (what economists refer to as "deadweight loss"), and still others may characterize what is often the larger economic effect of higher prices as welfare-neutral wealth transfers.

F. Burden on Proponents to Justify the Immunity on Cost-Benefit Grounds

The proponent of an immunity should have the burden of proof to justify the immunity on cost-benefit grounds. Of course, in the give-and-take of legislative proceedings, those who seek to persuade Congress that an immunity is not in the public interest should be required to muster factual support for any empirical claims they make as well.

IV. Stage 4: Tailoring an Immunity to Minimize Anticompetitive Effect

The Stage 4 inquiry should focus on substantive and procedural aspects of an otherwise acceptable immunity that can be tailored to minimize the anti-consumer effect.

A. Ruling Out Less Restrictive or More Beneficial Alternatives

Even if there are clear benefits to immunizing conduct that would otherwise be subject to antitrust scrutiny, it is important for Congress to determine if the benefits of the immunity could be obtained in ways less restrictive to the competitive process. In other words, could the benefits of the immunity be obtained in less costly ways than granting an antitrust immunity? Alternatively, would an alternative solution solve the problem imposing the same amount of costs as the proposed immunity, but also providing additional benefits?

B. Defining Scope and Explicit Carve-Outs

Careful drafting of legislation granting an antitrust immunity is essential if legislation is to serve the public interest without also permitting anti-consumer conduct that Congress did not intend to immunize. Two drafting techniques may appear self-evident but are worth formal incorporation in a well-designed immunity framework.

First, the scope of immunized conduct should be well-defined by clear textual language, supplemented by clear examples of legislative intent in the committee report. Textual ambiguities cause uncertainty among business planners, result in costly litigation over the scope of the immunity, and potentially result in judicial interpretations that do not reflect congressional intent, so that legitimate conduct is found illegal under the antitrust laws and harmful conduct is immunized. Second, when the foregoing analysis demonstrates that specific conduct within the general scope of a proposed immunity would not be socially beneficial, drafters should craft an explicit "carve-out" so that such conduct does not receive an unwarranted immunity.

C. Internal Structure of Joint Ventures

Historically, Congress has predominantly seen fit to immunize collaborative behavior among firms that otherwise compete in relevant markets. An important aspect of joint venture activity that has received sporadic but well-deserved attention in the case law,[43] but that Congress would be well-advised to consider as part of the immunity process, concerns limits on the internal structure of joint ventures to assure that they operate in an efficient manner to achieve the socially beneficial goals that Congress may seek to facilitate. Especially when collaborations face insufficient competition, so that (in Judge Posner's phrase), when they err, market retribution will *not* be swift,[44] it is important that the venture is structured so that efficient activity is not inhibited by the incentive of each participant to look out for its own interests rather than for the interests of the joint venture as a whole. Specifically, (i) each participant should be allowed to

[43] *See, e.g.,* Joseph F. Brodley, *Joint Ventures and Antitrust Policy,* 95 HARV. L. REV. 1521, 1528-29 (1982).

[44] *Valley Liquors, Inc. v. Renfield Importers, Ltd.,* 678 F.2d 742, 745 (7th Cir. 1982).

pursue pro-competitive actions outside of the joint venture unless such participation would clearly inhibit or free ride on collaborative activity; (ii) the management of the joint venture should have incentives to maximize the value of the joint venture's operations; and (iii) the venture should not allow a minority of participants a veto over operations that would benefit the venture as a whole.[45]

D. Transparency in Consideration of Competitive Concerns in Regulated Industries

Where Congress contemplates an antitrust immunity in a regulated industry, it will usually reflect a concern that allowing government or private antitrust litigation that challenges approved conduct would frustrate the regulator's ability to accomplish its statutory goals. In carrying out this function, regulators are often charged with considering both competitive concerns and other regulatory concerns. In these situations, is important that the FTC or DOJ be the principal agency responsible for determining the competitive effect of the challenged conduct, and their determination ought to be binding upon the regulatory commission. These antitrust enforcement agencies have the expertise and independence to assess fully the effect of regulated conduct on consumer welfare. If Congress wishes to allow non-consumer welfare concerns to prevail in specified instances, the regulator's ability to transparently determine that these concerns indeed should immunize otherwise unlawful activity will be assisted by the independent

[45] The textual discussion builds upon economic insights that suggest that often a collaboration works most efficiently when there is a "residual claimant" who keeps excess profits and therefore has an incentive to secure the approval (with side payments if necessary to those who might not initially benefit from a proposed business opportunity) of venture participants for efficient business opportunities. These insights suggest that, absent a firm or manager serving as this "residual claimant," there will be a "moral hazard" problem because participants have the incentive to free ride off of the efforts of others. *See, e.g.,* Bengt Holmstrom, *Moral Hazard in Teams,* 13 BELL J. ECON. 324 (1982); Armen Alchian and Harold Demsetz, *Production, Information Costs and Economic Organization,* 62 AM. ECON. REV. 777 (1972).

determination of the consumer welfare effects. Transparency in this context also can minimize the risks of special interest capture.

E. Potential Reporting and Approval Requirements

Finally, to ensure accurate data in the review process and to maximize the benefits perceived to arise from conferring the immunity, Congress may choose to create additional procedural safeguards. For example, Congress could create notice and reporting requirements.[46] This would promote transparency and aid in the provision of data in the review of the immunity. Congress also could require parties seeking immunity to get approval from a government official or agency to engage in the immunized conduct.[47]

V. Stage 5: Sunset Provisions and Regular Review

In the context of antitrust immunities, legislation ostensibly reflects a policy judgment that immunized conduct would currently confer a net benefit to society. In a dynamic economy, however, circumstances may change so that an immunity previously considered to be in the public interest may at some future time become socially harmful. Moreover, there is always a risk that affected parties and/or courts can misinterpret legislation granting an immunity. Policymakers can minimize these risks by means of

[46] For example, under the National Cooperative Research and Production Act, parties must submit written notification to the Department of Justice and the Federal Trade Commission identifying the parties to the joint venture, their nationality, and the nature and purpose of the venture. Parties also must submit written notification to both antitrust enforcement agencies regarding any changes in membership within 90 days of such change. 15 U.S.C. § 4305(a)(1).

[47] For example, the Small Business Act's immunities require approval of either the President in the case of national defense or approval from the Small Business Administration in the case of research and development. *See* 15 U.S.C. §§ 638(d), 640.

sunset provisions coupled with regular post-enactment review and the requirement that every immunity terminates unless renewed through an affirmative act of Congress.

Every immunity granted should include a sunset provision to ensure that the immunity is revisited periodically by policymakers and that the information, assumptions, and other factual bases for previously granting the immunity still justify its existence. Existing immunities should be amended to include sunset provisions and should be reviewed using the framework contained within this Report. If Congress opts to initiate a renewal process for a terminating immunity, the legislative history of its previous enactment will be particularly. Specifically, the legislative history of an immunity should identify the problem the immunity seeks to address, a description of how the immunity resolves the problem, the congressional calculus of benefits and costs described in Stage 3 (including specifying anticipated cost and benefits), and any limitations on the scope of the immunity. The most comprehensive legislative history would be contained in the conference committee report, and/or in a detailed report of the relevant committee or subcommittee.[48] Where this is not feasible, at a bare minimum the legislative sponsor should provide the necessary information and data in prepared floor remarks.

The regular reviews required as a result of a sunset provision enable policymakers to address any errors they perceive have arisen in interpretation of the immunity. Most importantly, the sunset provision provides policymakers with a fresh opportunity to examine the immunity with a greater level of information; they can examine its "track

[48] *See, e.g.,* George A. Costello, *Average Voting Members and Other "Benign Fictions": the Relative Reliability of Committee Reports, Floor Debates, and Other Sources of Legislative History,* 1990 DUKE L.J. 39.

record." As a rule of thumb, a reasonable length for these sunset periods is five years.[49] For certain immunities, however, it may be appropriate to have shorter or even slightly longer sunset provisions.

Prior to the expiration of a sunset period, policymakers should hold public hearings regarding possible renewal of the immunity. These reviews would be substantially similar to the process characterized in Stages 1 through 4, *supra*. However, in addition to examining the historical record of an immunity, policymakers should collect new information that was not available previously but could be relevant to their current analysis of that immunity. Key issues would include (i) whether economic or legal conditions have changed such that the problem would not exist even in the absence of the immunity; (ii) whether other potential (and less restrictive) alternative solutions could remedy the problem; and (iii) what effects the immunity has had since its passage or last renewal.

Participation of a wide range of stakeholders is critical to this review. Specifically, the enforcement agencies could provide information as to whether the immunity has deterred enforcement actions from taking place and the degree to which potential enforcement actions were subject to the immunity. Moreover, in instances where Congress required proponents of the immunity to undertake additional requirements (*e.g.*, notice and/or reporting filings), the enforcement agencies could provide data as to the number, nature, and breadth of such filings, as well as the degree to

[49] *See, e.g.,* Airline flight schedule exemption. 49 U.S.C. § 40129 (two year sunset provision for antitrust immunity); Need-Based Educational Aid Act. 15 U.S.C. § 1 note (seven year sunset provision for antitrust immunity); Television Program Improvement Act. 47 U.S.C. § 303c (three year sunset provision for antitrust immunity); Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, § 211, 118 Stat. 666, 666 (2004) (five year sunset provision for limitation on recovery).

which such filings were rejected. Finally, all interested parties could provide an assessment of the effects not anticipated when the immunity initially passed (or was last renewed).

This dynamic, as opposed to merely static, analysis would provide policymakers an opportunity to check the accuracy of the assumptions and forecasts upon which they based their previous opinions about the immunity. If certain costs or benefits turned out to be substantially different than anticipated previously, it could change the way policymakers view the immunity upon renewal.

Conclusion

Ultimately, the decision whether or not to create, modify, or eliminate an antitrust immunity is a political judgment made by the legislative and executive branches. The framework presented in this Report is intended to offer a policy tool to facilitate well-informed, transparent, and analytically sound deliberations in the course of that inherently political process. Specifically, this framework is designed to help policymakers identify the key issues with regard to (i) initial information gathering, (ii) identification and analysis of justifications for an immunity, (iii) balancing the costs and benefits of an immunity, (iv) tailoring an immunity to minimize anticompetitive effect, and (v) dynamic analysis of an immunity over time through the use of sunset provisions and regular review.

Appendix A

Specific Antitrust Immunities and Exemptions
(source: AMC's May 19, 2005 Request for Public Comment)

1. Capper-Volstead Act. 7 U.S.C. §§ 291-92.
2. Non-profit agricultural cooperatives exemption. 15 U.S.C. § 17.
3. Agricultural Marketing Agreement Act. 7 U.S.C. §§ 608b, 608c.
4. Fishermen's Collective Marketing Act. 15 U.S.C. §§ 521-22.
5. Webb-Pomerene Export Act. 15 U.S.C. §§ 61-66.
6. Export Trading Company Act. 15 U.S.C. §§ 4001-21.
7. McCarran-Ferguson Act. 15 U.S.C. §§ 1011-15.
8. Shipping Act. 46 U.S.C. app. §§ 1701-19.
9. Anti-Hog-Cholera Serum and Hog-Cholera Virus Act. 7 U.S.C. § 852.
10. Air transportation exemption. 49 U.S.C. §§ 41308-09.
11. Baseball exemption. *See* Curt Flood Act, Pub. L. No. 105-297, § 2, 112 Stat. 2824 (1998); *Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs*, 259 U.S. 200 (1922); *Toolson v. New York Yankees, Inc.*, 346 U.S. 356 (1953); *Flood v. Kuhn*, 407 U.S. 258 (1972).
12. Charitable Donation Antitrust Immunity Act. 15 U.S.C. §§ 37-37a.
13. Defense Production Act. 50 U.S.C. app. § 2158.
14. Filed rate/*Keogh* doctrine. *See, e.g.*, *Keogh v. Chicago & N. W. Ry. Co.*, 260 U.S. 156 (1922).
15. Health Care Quality Improvement Act. 42 U.S.C. §§ 11101-52.
16. Labor exemptions (statutory and non-statutory). *See, e.g.*, 15 U.S.C. § 17; 29 U.S.C. §§ 52, 101-10, 113-15, 151-169; *Connell Constr. Co. v. Plumbers & Steamfitters Local Union No. 100*, 421 U.S. 616 (1975).
17. Local Government Antitrust Act. 15 U.S.C. §§ 34-36.
18. Medical resident matching program exemption. 15 U.S.C. § 37b.
19. Motor transportation exemption. 49 U.S.C. § 13703.
20. National Cooperative Research and Production Act. 15 U.S.C. §§ 4301-06.
21. Natural Gas Policy Act. 15 U.S.C. § 3364(e).
22. Need-Based Educational Aid Act. 15 U.S.C. § 1 note.
23. Newspaper Preservation Act. 15 U.S.C. §§ 1801-04.
24. Railroad transportation exemption. 49 U.S.C. § 10706.

25. Small Business Act. 15 U.S.C. §§ 638(d), 640.
26. Soft Drink Interbrand Competition Act. 15 U.S.C. §§ 3501-03.
27. Sports Broadcasting Act. 15 U.S.C. §§ 1291-95.
28. Standard Setting Development Organization Advancement Act. 15 U.S.C. §§ 4301-05, 4301 note.
29. United States Postal Service exemption. *See, e.g.*, *United States Postal Serv. v. Flamingo Indus. Ltd.*, 540 U.S. 736 (2004).