The Intersection of Antitrust and Regulation

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In this paper, we want to address the various ways that antitrust policy intersects with regulation. We want to identify a set of historical patterns that we see in different regulated industries and also look at the legal instruments that serve to define the respective domains of antitrust and regulation of a particular regulated industry. We also wish to address the circumstances under which regulation achieved through antitrust alone will prove superior or inferior to regulation achieved through more targeted legislation or rules. That analysis will depend in part upon the difference in institutional frameworks through which United States antitrust policy is implemented and through which more targeted legislation is typically implemented.

Antitrust and regulation are two alternative ways to influence how prices get set. In one, a specialized body is created with expertise that allows it to set prices and operating procedures with a fair bit of detail. Regulation through antitrust involves more general constraints on competition and uses non-specialized courts to adjudicate disputes. Some have urged aggressive use of antitrust including creating duties to deal in order to avoid setting up regulatory bodies. Moreover, regulation

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itself has come under great scrutiny as the recognition has grown that regulators do not typically maximize social welfare.

The costs of regulation have led some to prefer little or no regulation other than a reliance on antitrust. In this chapter, we explore the interaction between antitrust and regulation. We believe that antitrust and regulation frequently should be viewed as complementary tools to be used in maximizing welfare when faced with the principal-agent problem of how a regulator should control a regulated industry. But the fact that antitrust and regulation can be used in that way does not mean that they will inevitably do so. In some industries, regulations have created immunities from antitrust inquiry. We will try to use standard public choice tools to examine that pattern and try to understand the circumstances under which regulation will displace the possibility of antitrust oversight.

I. Patterns of Interaction

A. Temporal Patterns

We conjecture that we frequently see a sequence of regulation through antitrust followed by targeted legislation. One of the core drivers for this conjecture is the fact that the Sherman Act is generally applicable and antitrust lawsuits are initiated easily. The very flexibility and broad applicability of the Sherman Act means that it is an easy entry point for potential regulation of an industry. And the result of a lawsuit then sets the stage by establishing a temporary property right in the new status quo. That property right establishes a context in which subsequent negotiation and competition can take place through legislation. We think this pattern describes telecommunications, where the modified final judgment that emerged in the antitrust litigation against AT&T was subsequently followed by the Telecommu-

nications Act of 1996. We think we see a similar pattern in electricity where the *Otter Tail* decision was subsequently followed by the Energy Policy Act of 1992. In both cases, we can trace the importance of antitrust both in opening up the industry to competition and in easing its transition to deregulation.

B. Legal Instruments of Organization

Statutes frequently address directly the extent to which antitrust law continues to operate in the face of legislation operating in a particular regulated industry. Two approaches are of particular interest: (i) so-called "savings" clause which specify how general antitrust law overlaps with the legislation and (ii) provisions that create antitrust immunity in a particular area.

How savings clauses operate has been of particular interest recently in telecommunications. The Telecommunications Act of 1996 contains a savings clause[1] and the courts of appeal divided on how it should be understood.[2] The Supreme Court's recent decision in *Trinko* articulates one view of the way that antitrust should step back in the presence of comprehensive legislation. We want to examine that and other situations in which savings clauses have been put in issue. We also want to examine the role of dual enforcement where both the Department of Justice and an area regulator—for example, the FCC or the Surface Transportation Board—have authority to investigate mergers.

In some industries, we see direct regulatory limitations on antitrust's usual operation. Consider railroads, where the Anti-

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[1] "Nothing in this Act or the amendments made by this Act ... shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws." 47 U.S.C. § 152, Historical and Statutory Notes.

[2] Goldwasser v. Ameritech Corp., 222 F.3d 390 (7th Cir. 2000); Law Offices of Curtis V. Trinko, L.L.P. v. Bell Atlantic Corp., 294 F.3d 307 (2nd Cir. 2002).

trust Division of the Department of Justice has opposed almost every recent rail merger, but where the same mergers have sailed past the Surface Transportation Board. What explains the presence of the savings clause in the Telecommunications Act but the broad antitrust immunity in railroads? Does it reflect the differing power of potential entrants and customers in the two industries or something else?

Whether there is an antitrust saving clause has less to do with penalties (the regulator could impose treble damages if it wanted) but more to do with giving certain interest groups a voice in the setting of industry operations. Viewed in this light, the antitrust laws are a tool to shape regulation and some interest groups may feel that they can do better in the courts than in the regulatory forum.

Finally how the antitrust law deals with professional organizations that self regulate is an important topic. There have been several developments in the past several decades that have lessened the collective power of such industries to impose harms on consumers in the guise of professional standards. Collective actions in health care (doctors collectively negotiating with hospitals or hospitals collectively negotiating with pharmacy benefit groups) continue to raise difficult issues at the intersection of antitrust and regulation.

II. Substantive Differences

We think antitrust and regulation differ importantly in how they grapple with some key policy issues. Take two examples: mandatory dealing obligations/essential facilities and cross-subsidization Ramsey pricing.

A. Mandatory Dealing Obligations and Essential Facilities

We conjecture that regulation may be a superior way of creating and implementing mandatory dealing obligations. Again, industry participants will naturally look to antitrust as a starting point for creating these obligations, especially given the uncertain dimensions of the essential facilities doctrine in United States antitrust law. But antitrust is much better situated to say no than it is to say yes. That affirmative dealing obligation puts the court in the position of needing to articulate detailed specifications as to how complex industry actors will interface and at what prices, in a context in which one or more of the parties will have very little incentive to cooperate.

The point here is fundamentally informational, about whether a court or a regulatory body is better suited to hearing and evaluating evidence, the types of information and evidence and the structure for presenting the information in the context of the court setting versus what might be achievable through administrative regulation and control.

Antitrust will also wrestle with its fundamental ambivalence about joint dealings where, on the one hand, antitrust law condemns collective behavior and where, on the other, antitrust law has an uncertain set of required-dealing obligations. The *Aspen Skiing* case is the classic example of this, where the Supreme Court imposed a mandatory dealing obligation for shared tickets for skiing on Aspen mountains, and at the same time, the Colorado Attorney General had seen the original behavior as possible illegal price-fixing.

A duty to deal using the essential facility doctrine is one way to restrict a natural monopoly. But such a duty can only really prevent regulatory evasion through vertical integration and cannot control the natural monopoly. Moreover the setting of price terms especially in an industry undergoing rapid technological change is a nightmare (witness telecom) where each

state supposedly using the same algorithm of the FCC wound up with access prices differing by a factor of 10. *Trinko* seems to have destroyed the viability of that doctrine especially for a court to set prices.

B. Cross-Subsidization and Ramsey Pricing

In general we know that regulation leads to cross subsidy, nonlinear prices, and frequently some version of Ramsey pricing. Cross subsidies create entry incentives. General antitrust law will often facilitate entry but will do so with little regard for the cross-subsidy issues. MCI's entry into long distance probably fits in this framework. Historically, regulated industries regulation has controlled entry and that control over entry gives regulators more policy instruments to implement cross-subsidy pricing. It also creates the possibility of regulatory capture and powerful rent-seeking which the antitrust laws can be used to constrain.

The subsidization question also takes us to the question of how state and federal antitrust laws should operate together. One question is whether state regulators are more prone to cross subsidization. If so, they will not want the antitrust laws as a constraint on their ability to maximize political support. As a general matter, when will regulators have the power to avoid the antitrust laws constraining effect in industries subject to regulatory capture?