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Private v. public antitrust enforcement: A strategic analysis ☆

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ABSTRACT

We compare private and public enforcement of the antitrust laws in a simple strategic model of antitrust violation and lawsuit. The model highlights the tradeoff that private firms are initially more likely than the government to be informed about antitrust violations, but are also more likely to use the antitrust laws strategically, to the disadvantage of consumers. Assuming coupled private damages, if the court is sufficiently accurate, adding private enforcement to public enforcement always increases social welfare, while if the court is less accurate, it increases welfare only if the government is sufficiently inefficient in litigation. Pure private enforcement is never strictly optimal. Public enforcement can achieve the social optimum with a fee for public lawsuit that induces efficient information revelation. Private enforcement can also achieve the social optimum with private damages that are efficiently multiplied and decoupled.

1. Introduction

In the U.S., Section 7 of the *Sherman Act of 1890*[1] and Section 4 of the *Clayton Act of 1914*[2] entitle any firm to bring a lawsuit against a competitor for three times the damages suffered from any violation of the antitrust laws. Private enforcement of the antitrust laws is thus explicitly permitted and indeed encouraged, and supplements public enforcement by the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission. In contrast, in Canada, *The Combines Investigation Act of 1889*[3]

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[1] An Act to protect trade and commerce against unlawful restraints and monopolies, ch. 647, 26 Stat. 209 (1890), current version at 15 U.S.C. Section 1 et seq. (2003).

[2] An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes, ch. 323, 38 Stat. 730 (1914), current version at 15 U.S.C. Section 12 (2003).

[3] An Act for the prevention and suppression of combinations formed in restraint of trade, S.C. 1889, c. 41.

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contained no provision for private antitrust enforcement until an amendment was added to it in 1976. The amendment only entitles a firm to bring a lawsuit for single (not treble) damages. Moreover, the courts have been ambivalent as to its constitutional validity. As a result, private antitrust enforcement actions have been rare. Similarly, in Europe, the antitrust system has largely discouraged private enforcement, in favor of public enforcement. In both Canada and Europe, policy-makers are now debating whether to change competition laws to encourage more private enforcement.[4] The European Commission (2005) recently released a Green Paper on proposals for new measures to encourage private antitrust enforcement.

Private enforcers have greater incentive to take enforcement action than public enforcers, which may benefit society through additional deterrence. But this is a double-edged sword. Private enforcers also have greater incentive to use the antitrust laws strategically, that is, to use the laws to win in the courts what they were unable to win in honest competition with their rivals. For example, firms may use the antitrust laws to prevent large potential competitors from entering their market, as in the classic case of Utah Pie Co. v. Continental Baking (386 U.S. 685, 1967, U.S. Court of Appeals, 1978).[5] Firms can also use the antitrust laws to prevent their rivals from competing vigorously, extort funds from successful rivals, improve contractual conditions, enforce tacit collusive agreements, respond to existing suits, and prevent hostile takeovers. These strategic uses of the antitrust laws (which often have little to do with promoting efficiency) are explained and documented with many recent U.S. antitrust cases in McAfee and Vakkur (2004) and McAfee, Mialon, and Mialon (2006).

However, private enforcers also have other advantages over public enforcers. Their costs of detecting possible violations and gathering initial evidence are lower. Public enforcers regulate a vast array of industries, and therefore cannot detect anticompetitive practices as easily as private enforcers who experience these practices on a regular basis. In general, private enforcers are better informed about their particular industry. As Shavell (1984) argues, "private parties should generally enjoy an inherent advantage in knowledge" over public regulators. They are naturally in a superior position to estimate the benefits and costs of their own activities and those of their close competitors. "For a regulator to obtain comparable information would often require virtually continuous observation of parties' behavior, and thus would be a practical impossibility" (p. 360). Also, as Brodley (1995) argues, "competitors and takeover targets are ideal litigants in terms of litigation capability because they are likely to have the skill, knowledge of the industry, and motivation to mount a powerful case with speed and precision" (p. 35).

In this paper, we compare private and public antitrust enforcement in a simple strategic model of antitrust violation and lawsuit. The model highlights the tradeoff that firms are initially more likely than the government to be informed about antitrust violations, but are also more likely to use the antitrust laws strategically, to the detriment of consumers. Firms choose whether to take an action that either violates the antitrust laws or improves their own efficiency, the government chooses whether to sue them publicly, and rival firms choose whether to sue them privately. Initially, the rival firms are better informed than the government about whether an illegal or efficient action is taken. The government only wants to sue if an illegal action is taken, but rival firms may want to sue even if an efficient action is taken. The model is solved for its equilibrium outcomes under different enforcement mechanisms (including pure private, pure public, and public combined with private enforcement), which are then compared in terms of social welfare.

Adding private enforcement to public enforcement is always socially beneficial if the court is sufficiently accurate, i.e., likely to rule in favor of the defendant when the defendant is innocent and against the defendant when the defendant is guilty. In this case, firms never strategically abuse the laws, only suing when their competitors have committed an antitrust infraction, so that private enforcement only serves to counter antitrust harm. But if the court is less accurate, adding private enforcement is beneficial only if the government's litigation costs, which depend on its efficiency, are sufficiently high. In this case, firms always sue when their rivals take efficient actions, preferring to take a chance with the courts than suffer a certain loss in market share. Society benefits from private suits only if the government is sufficiently inefficient in litigation and the legitimate private suits outweigh the strategic suits.

We find that the combination of private and public enforcement tends to lead to a greater probability of private than public action, as is observed empirically. In most cases, firms have sufficient incentive to sue if they learn that their rivals have actually violated the antitrust laws. Knowing this, the government has little reason to sue, since it can expect that most of the rightful suits are already being initiated privately. Thus, public enforcement tends to give way to private enforcement when the two are in play. This is consistent with the observation that private antitrust suits have outnumbered public suits in the U.S. by a 9-to-1 ratio from 1970 to 1995.[6]

In the model, the government only has reason to sue if the litigation costs of private firms are very high. But in this case, firms never sue, even if they know that their rivals would otherwise get away with an antitrust violation, so that pure private enforcement yields lower welfare than public enforcement, whether or not the latter is combined with private enforcement, as long as society prefers some public enforcement to no enforcement at all. Moreover, in the majority of cases, where the government has no reason to sue, private combined with public enforcement is equivalent to pure private enforcement. Hence, pure private enforcement is never strictly optimal.

[4] Roach and Trebilcock (1996) compare the antitrust enforcement systems in the U.S., Canada, and Australia. Wils (2003) and Ginsburg (2005) compare the antitrust enforcement systems in the U.S. and Europe. These papers also discuss in detail the pros and cons of private antitrust enforcement in general.

[5] Utah Pie is a small firm that produces fresh pies in Salt Lake City, Utah. To counter the arrival of three much larger national competitors that were attempting to penetrate the market by selling frozen pies, Utah Pie initiated an antitrust suit, arguing that the arrival of the new entrants was an attempt to monopolize the market. The Supreme Court ultimately ruled in favor of Utah Pie. The smaller Utah Pie successfully used the antitrust laws to prevent three formidable potential competitors from entering its market. Competition alone would not likely have produced this outcome.

[6] NAFTA Working Group, Private Actions for Violations of Antitrust Laws, Appendix A.