Private Antitrust Enforcement

Compensation, Deterrence, or Extortion?

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Both the Sherman and the Clayton Acts allow "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws . . . [to] recover three-fold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." In addition to private individuals, the term "person" has been interpreted to include corporations, partnerships, and other business entities as well as municipalities, states, and foreign governments.

The right of private parties to sue under the antitrust laws has been circumscribed somewhat by judicial decisions requiring that the antitrust injury be "direct." For example, third parties that pay higher prices because of anticompetitive acts or practices, customers of fringe firms that charge the cartel price without being direct parties to the price-fixing conspiracy, and competitors injured by the lower prices made possible by a merger, even a merger held to be unlawful, have all been denied the right to sue for treble damages.

Despite such limitations, private suits are clearly where the action is in antitrust, at least since the early 1960s. Unfortunately, the available data on private antitrust litigation are very poor. Except for matters in which there is a reported decision, no record exists of the private cases filed before 1938. By most accounts, though, private antitrust suits were uncommon before 1960, and few plaintiffs were successful. One estimate suggests that a decision was reached in only 158 private damage suits between 1890 and 1940; another places this number at 175. It is estimated that about 423 private cases were initiated over this entire period, with plaintiffs prevailing in only 13 of the reported decisions. There were 619 private cases reported between 1940 and 1959, and the plaintiff was successful in just 20 of the 144 private antitrust decisions recorded between 1952 and 1958.

Nothing in the historical data presaged the explosion in private antitrust litigation that began in 1960. Since then, the number of private cases filed annually has consistently outpaced government law enforcement efforts by a wide margin. Indeed, more than 1,000 private antitrust suits have been initiated every year since 1971 (see Table 1).

The reasons for this dramatic increase in private antitrust litigation are not well understood.
Treble damages have been held partly responsible, but this remedy was available from the beginning. Several procedural changes were adopted during the 1960s, including new rules governing class-action suits, but these changes do not seem to have been significant enough to have triggered the dramatic rise in private litigation.

It is worth noting that many private antitrust suits follow successful government prosecutions;

The treble-damage remedy in private antitrust suits promotes protracted litigation, encourages nuisance suits designed to extort large monetary settlements, and creates perverse incentives that magnify rather than mitigate the social cost of monopoly in the economy.

A single government case often spawns a large number of private damage suits against the same defendant. In the electrical equipment conspiracy case decided in 1962, for example, private litigants filed some 2,233 treble-damage actions against the coconspirators in the wake of the government’s victory. Two-thirds (986 of 1,456) of the private antitrust cases commenced between 1946 and 1963 were preceded by successful Justice Department prosecutions of the same defendants. Private plaintiffs often free-ride on public law enforcement efforts by suing for treble damages after the respondents have been found guilty in a government antitrust case. In fact, section 5(a) of the Clayton Act declares that a “final judgment or decree . . . to the effect that a defendant has violated” the antitrust laws “shall be prima facie evidence against such defendant” in subsequent private suits. Much private antitrust litigation centers, therefore, on resolving claims of injury and calculating consequent monetary damages instead of focusing on proving guilt.

Enough is known about private antitrust suits to make them a growing cause for concern. Richard Posner has written that the “ burgeoning of the private antitrust action has induced enormous, and I think justified, concern about the overexpansion of the antitrust laws and their increasing use to retard rather than promote competition.” Critics contend that the treble-damage remedy promotes protracted litigation, encourages nuisance suits designed to extort large monetary settlements, and creates perverse incentives that magnify rather than mitigate the social cost of monopoly in the economy. William Baumol and Janusz Ordover have recently suggested that treble damages “provide a direct incentive for protectionist activity,” that is, an incentive for using the antitrust laws in anticompetitive ways.

If that is not enough, the direct costs of private
antitrust litigation can be staggering. Steven Salop and Lawrence White estimated that litigation costs average $200,000 to $250,000 per case, or approximately $250 million per year for all private suits filed in recent years.

The number and cost of private antitrust suits raise important questions about the role played by private parties in the enforcement of the antitrust laws. Yet private antitrust cases have been the least studied (and therefore the least understood) aspect of the enforcement process.

One of the most troubling aspects of private antitrust enforcement is the frequency with which firms bring suits against their competitors. Of course, it is possible that specialized business knowledge puts competitors in the best position to spot unlawful activities. But another possibility is that firms employ the antitrust laws as a weapon to handicap their successful rivals: firms attempt to win in the courts what they are unable to win in the open marketplace. I examine the latter possibility in some detail and show how firms might fruitfully employ the antitrust laws to their own advantage.

Incentives to Sue, Settle, and Litigate

There is a long-standing debate about the purpose of private antitrust enforcement. One side sees its main objective as enabling parties harmed by anticompetitive acts or practices to receive compensation for injuries sustained (that is, to be made whole by recovering the monetary damages they have suffered). Another viewpoint holds that private antitrust enforcement should help provide deterrence, that is, it should help prevent law violations from occurring in the first place.

The decision to commit any crime, including a violation of the antitrust laws, can be described as a solution to a cost-benefit problem. The prospective criminal compares the expected gain from illegal activity with the expected cost, where the cost is the penalty assessed if the violation is detected and punished. As such, obedience to the law can be taken for granted only if the rate of return to crime is negative. If detection and punishment are certain, the penalty required to deter a law violation will be less than if the law enforcement process works only imperfectly. If not all those who break the law are caught, or if punishment is uncertain even when a violation is uncovered, then the penalty must be increased to maintain a given level of deterrence.

Injured parties deciding whether to sue also face a decision problem involving a comparison of the expected damage award with the cost of pursuing the suit. Under what conditions will private parties harmed by antitrust violations sue to recover damages, and what factors determine whether the adversaries will litigate their dispute or settle out of court?

One of the most troubling aspects of private antitrust enforcement is the frequency with which firms bring suits against their competitors. It is possible that specialized business knowledge puts competitors in the best position to spot unlawful activities. It is also possible that firms attempt to win in the courts what they are unable to win in the open marketplace.

Decisions concerning whether to sue, and then whether to litigate or to settle, depend on the maximum amount the defendant is willing to offer in a settlement. This, in turn, depends on the defendant's expectations about the probable size of court-awarded damages plus litigation costs. Uncertainty clearly plays an important role in the positions of both plaintiffs and defendants. More precisely, differences in the adversaries' perceptions of the plaintiff's probability of success should litigation occur heavily influence the method of dispute resolution. Litigation will be more likely the more optimistic the plaintiff, the lower the defendant's estimate of the plaintiff's probability of success, the larger the judgment at stake, and the lower the competing parties' legal costs. Note that if both parties form the same estimate of the plaintiff's probability of winning, no matter how high or low the estimate is, the suit will be settled out of court because settlement avoids the cost of litigation. Litigation is only rational when the extent of disagreement about the expected outcome exceeds the cost of trial.

The data concerning private antitrust suits consistently show that a large proportion of
these disputes are settled rather than litigated. William Baxter, for example, found that nearly 82 percent of the 671 private antitrust cases disposed of between 1964 and 1970 were resolved by settlement between the two parties. Similarly, after analyzing detailed information concerning more than 2,350 private antitrust cases filed between 1973 and 1983, Salop and White found that 73 percent of the suits were settled before reaching trial. These numbers are made more remarkable by the fact that plaintiffs appear to have a low success rate in those cases that actually proceed to a final court judgment. Baxter estimated that plaintiffs win final judgments only 15 percent of the time. Salop and White, examining a later time period, placed the proportion of plaintiffs’ wins at 28 percent.

The tendency for private antitrust suits to be resolved through settlement implies that the defendants typically view their financial exposure at trial to be unacceptably high because of the expense of litigation or the size of the expected judgment or both.

On the other hand, the defendant in these cases faced a 28 percent probability of having to pay damages of $456,000 plus the plaintiff’s legal costs. If we assume that the defendant would incur similar legal expenses from litigation, the average defendant’s expected financial exposure at trial was $244,400. For the average case, then, both parties would be inclined to settle out of court for some figure between $62,000 and $244,400.

Initiating a private antitrust suit thus appears to be a profitable strategy for the average plaintiff. Whether this is so because uncertain legal standards in antitrust cases lead defendants to form relatively high estimates of plaintiffs’ chances of success, because the treble-damage remedy raises the stakes to an unacceptable level, or simply because litigation is costly, the possibility exists that the divergence in expected values between plaintiff and defendant will be exploited in the form of “nuisance” suits by plaintiffs or, even worse, attempts to extort large settlements from profitable enterprises.

Extortion by Litigation

The decision to “invest” in antitrust as a method of competition is no different from any other capital-budgeting problem the firm confronts. Faced with a loss of sales to a new or established rival, the firm can respond by cutting price, by improving product quality, by increasing its advertising expenditures, or by taking any of a number of other actions that characterize the normal workings of a competitive market economy. Alternatively, the firm can appeal to the government for protection. It can lobby for favorable legislation, attempt to influence a bureaucratic ruling, or instigate an antitrust lawsuit either on its own or by supplying information about possible violations to the public antitrust enforcers. Which of these various options is chosen in any given circumstance is primarily a matter of selecting the strategy offering the highest expected rate of return to the firm.

In short, the power residing in the antitrust laws to declare illegal certain business practices thought to be anticompetitive is also a power that can be used to subvert the competitive process. A law that declares mergers to be illegal where they would tend to create a monopoly can be used to prevent
mergers that will make life uncomfortable for rivals by promising to generate substantial cost savings. A law that declares selective price cutting to be illegal where the effect would be to injure competitors unfairly can be used against a rival that, by virtue of superior efficiency, is able to offer lower prices to customers.

The interest-group theory of government teaches that whenever a public policy process can be mobilized to benefit selectively the few at the expense of the many, those who can gain from that policy will use it strategically. This is not to say that such behavior represents a misuse or abuse of the policy process in any meaningful sense. Rather, the pursuit of wealth transfers (or the defense of existing wealth) through the antitrust laws simply reflects rational, self-interest-seeking behavior under given constraints. Nor is it necessary to inquire into the motives of the framers of antitrust. Whether antitrust was designed as a wealth-transfer mechanism or, instead, transfer-seeking is an unintended or unforeseen consequence of a policy meant to promote consumer welfare, the antitrust laws do offer a mechanism by which firms can benefit themselves at the expense of their rivals and the consumers of their products.

Consider Section 7 of the Clayton Act, which declares mergers between horizontal competitors to be illegal “where the effect is to substantially lessen competition or tend to create a monopoly.” Many mergers result in the closure of outmoded production facilities, the replacement of incumbent managers, the combination of duplicative product distribution networks, and other synergistic effects that promise to reduce costs. Increased economic efficiencies of this sort will increase the wealth of the owners of the firm targeted for takeover and will benefit consumers by allowing the product to be produced and sold more cheaply. At the same time, however, rival sellers are faced with the prospect of increased competitive pressures. They can respond by attempting to emulate the organizational innovations the merger partners plan to implement or by taking other steps to lower their own costs. Alternatively, the competitors, complaining of a possible violation of the merger law, can sue. They will almost surely be joined in the antitrust action by the managers and employees who stand to lose their jobs and by local public officials in the areas where plant closures are scheduled. These demands for protectionism can be met if the antitrust authorities and the courts can be induced to adopt a sufficiently narrow market definition such that the market

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shares and market concentration levels generated by the proposed merger go beyond the thresholds required for finding a merger law violation.

Of course, it is possible that opposition by competitors to a proposed merger could arise from a public-spirited attempt to check an increase in monopoly power that reduces consumer welfare. After all, rivals will have access to the specialized information about market conditions necessary to distinguish between mergers that enhance efficiency and those that increase market power. Surely the antitrust authorities and the courts should be able to see through and reject competitors' complaints that are nothing more than self-serving attempts to handicap their rivals.

Neither of these possibilities, however, seems consistent with the facts in private antitrust case law. One example is sufficient to illustrate the power of antitrust to subvert competition. In 1983 General Motors Corporation and Toyota
sought to enter into a joint venture to produce a
new subcompact automobile in the United
States. The plan involved combining GM pro-
duction facilities in Fremont, California, with
Japanese-supplied engines and Toyota's designs
and managerial expertise to produce an Ameri-
can version of the Toyota Corolla. GM claimed
that the venture would generate substantial eco-

donomic benefits by allowing its managers to learn

The 1983 petition by Chrysler and Ford for
the FTC to halt a joint venture by their
competitors, GM and Toyota, to produce a
new subcompact car is an example of the
power of antitrust to subvert competition.
The joint venture was ultimately approved,
but GM and Toyota were ordered to limit
their production of the new vehicle.

from Toyota the secrets that make Japanese au-
tomobile manufacturers more efficient than
their U.S. counterparts. GM would presumably
then seek to apply those secrets in its other
plants.

Soon after the agreement was announced,
both Chrysler and Ford, the horizontal com-
petitors of GM and Toyota, petitioned the Federal
Trade Commission to halt the joint venture.
Chrysler and Ford argued that the combination
of two of the world's largest automobile com-
panies would substantially lessen competition in
two ways. First, they contended that because
GM and Toyota proposed to set the price of the
new vehicle by reference to the average price of
other specified subcompact car models they pro-
duced, the exchange of information between the
two firms would facilitate collusion. Second,
Chrysler and Ford alleged that the joint venture
would increase GM's market power in the mar-
ket for larger-sized automobiles. To substantiate
their argument, Chrysler and Ford presented re-
sults from marketing studies showing that con-
sumers exhibit a high degree of brand loyalty. As
the incomes of first-time car buyers increase
over their lifetimes, they tend to "trade up" to a
more expensive model produced by the same
manufacturer. For this reason, auto makers al-
ledgedly regularly sell subcompact cars at lower
margins with the expectation of higher future
sales of large vehicles at higher profit margins.
Chrysler and Ford claimed that sales of the joint-
venture vehicle, which was to be distributed
through GM's franchised dealers, would allow
the firm to "lock in" additional customers to its
product line so that GM would eventually cap-
ture a greater share of the market for larger au-
tomobiles.

Chrysler and Ford's opposition to the GM-
Toyota joint venture illustrates what may be a
general principle of antitrust analysis, namely
that opposition by horizontal competitors is
prima facie evidence that the challenged prac-
tice promotes competition. If, as Chrysler and
Ford claimed, the GM-Toyota agreement would
have facilitated collusion or increased GM's mo-
nopoly power in any segment of the domestic
automobile market, then their silent acquies-
cence would have been expected. Any attempt on
the part of the joint venturers to charge supra-
competitive prices would present the horizontal
competitors—Chrysler and Ford—with two profi-
table options. They could either raise their
prices as well or they could maintain their prices
at existing levels and thereby gain sales at the
expense of the colluders. On the other hand,
complaints by rivals are predictable if the joint
venture is likely to result in lower cost or im-
proved product quality. In that event market
forces place rivals at a competitive disadvan-
tage. As Baumol and Ordover have observed, ex-
cluded competitors must then "run correspond-
ingly faster . . . to stand still."

The FTC ultimately approved the GM-Toyota
joint venture. But, the commission also provided
Chrysler and Ford with an important victory by
ordering GM and Toyota to limit their produc-
tion of the new vehicle to no more than 250,000
units per year. This output restriction, which is
hardly consistent with antitrust's stated goal of
promoting consumer welfare, prevents GM and
Toyota from taking full advantage of prospective
scale economies and thus results in higher aver-
age production costs than might otherwise have
been realized. Such an outcome is, however, con-
istent with a prediction of the interest-group
theory of government, namely that no one inter-
est group will get all that it wants from regula-
tion.

The GM-Toyota matter was not an isolated in-
cident. Private antitrust cases tend overwhelm-
ingly to fall into two basic categories: suits filed by firms charging their competitors with unlawful conduct and suits filed by downstream business entities—dealers, business customers, franchisees, and licensees—charging their suppliers with unlawful conduct.

As Table 2 shows, downstream firms as a group represented the largest category of private antitrust plaintiffs from 1973 to 1983. These complainants tended to charge their suppliers with vertical price-fixing, refusals to deal, and unlawful terminations of their business relationships. Competitors most often complained of conspiracy, predatory pricing, and other horizontal restraints of trade and were also the private parties most likely to challenge mergers and joint ventures.

The possibility that some, if not all, of these complaints were designed to extort monetary settlements from defendants arises because even if a defendant thinks that the plaintiff’s suit is likely to fail at trial, it still might be rational to settle out of court for some amount less than the expected costs of litigation. Settlement becomes even more worthwhile if the defendant is concerned that a final judgment in favor of the plaintiff will invite follow-on suits or have adverse consequences for other cases, or if the plaintiff’s suit seeks injunctive relief in addition to monetary damages.

There is reason to suspect that most private antitrust litigation is driven by extortion motives. Although the dimensions of the problem are far from clear, some limited evidence suggests that more benign compensation and deterrence motives simply do not explain a large number of private suits. For example, Pauline Ippolito reviewed data from 130 private antitrust cases charging the defendant with the illegal use of resale price maintenance (RPM). She discovered that 87 percent of these private RPM suits were initiated by dealers against their upstream suppliers. Most of the dealers who complained had, for various reasons, been terminated as the manufacturer’s authorized distrib-

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Table 2: Plaintiff’s Relationships to Defendants in Private Antitrust Cases

<table>
<thead>
<tr>
<th>Relationship</th>
<th>Frequency</th>
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</thead>
<tbody>
<tr>
<td>Competitor</td>
<td>36.5%</td>
</tr>
<tr>
<td>Downstream Business Entity</td>
<td>51.4%</td>
</tr>
<tr>
<td>Dealer</td>
<td>27.3%</td>
</tr>
<tr>
<td>Customer Company</td>
<td>12.5%</td>
</tr>
<tr>
<td>Franchisee</td>
<td>1.6%</td>
</tr>
<tr>
<td>Licensee</td>
<td>1.3%</td>
</tr>
<tr>
<td>Final Customer or End User</td>
<td>8.7%</td>
</tr>
<tr>
<td>Supplier</td>
<td>5.6%</td>
</tr>
<tr>
<td>Employee or Former Employee</td>
<td>3.5%</td>
</tr>
<tr>
<td>State or Local Government</td>
<td>1.4%</td>
</tr>
<tr>
<td>Other</td>
<td>12.7%</td>
</tr>
<tr>
<td>No Information</td>
<td>13.8%</td>
</tr>
</tbody>
</table>

Note: Percentages total more than 100% because a complaint may involve more than one business relationship.
Source: Salop and White (1986).
even more prevalent in private antitrust litigation than Klein's study indicates. Both the significant proportion of private suits that are initiated either by competitors or by firms having an existing or prior business relationship with the defendant and the high settlement rates that characterize these actions reinforce this conclusion.

The evidence, however, is far from conclusive. The high percentage of out-of-court settlements could indicate that private antitrust enforcement is a well-functioning system in which law violations are deterred and victims of illegal conduct receive compensation while economizing on costly litigation to the adversaries' mutual benefit. But as Salop and White have observed, "once the possibility of extortion is added to the analysis . . . a high settlement rate could indicate that antitrust is a blackmailer's paradise."

Concluding Remarks
The case for characterizing antitrust as a mechanism for wealth redistribution, or what Robert Bork called predation through governmental processes, is based on three distinct, but related, contributions to the literature on public policies toward business. First, it has been repeatedly demonstrated that public antitrust cases are not selected on the basis of their potential net

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fits to society. Second, research has shown that the enforcement process is subject to political influences. Third, the economic literature on antitrust has been highly critical of enforcement efforts in a large number of specific cases.

More fundamentally, however, the emerging appreciation of the incentives of some firms to use antitrust policy to subvert competition is grounded in the theories of economic regulation and rent-seeking. Interest groups that expect to receive concentrated benefits and enjoy low costs of mobilizing their members politically have an incentive to lobby for regulatory favors that increase their members' wealth at the expense of groups whose interests are more diffuse or who are less well organized. The regulators, in turn, serve as brokers of these wealth transfers in their aim to maximize political support.

The rent-seeking model simply suggests that decisions concerning the strategic use of governmental processes to secure or protect above-normal profits, or rents, is a capital-budgeting problem not unlike most other investment choices the firm must make. That is, along with conventional methods of price and nonprice competition, the investment strategies available to the firm include lobbying for favorable legislation or attempting to influence a bureaucratic ruling. Instigating an antitrust suit is just one other option in this regard. From an analytical viewpoint, all of these possible courses of action are equivalent and serve one and the same purpose, namely to gain a competitive advantage over rivals vying for access to a rent. The particular strategy chosen in any given circumstance will simply be the one that offers the highest expected rate of return.

The strategic use of antitrust processes to subvert competition offers at least two advantages over conventional forms of rivalry. If the government is induced to sue a firm's competitor, the costs of litigation can be shifted to the general taxpayer. More important, the police power of the state is brought to bear on the tasks of adjusting and monitoring the behavior of rivals. An antitrust decree enforced by public prosecutors and the courts affords a unique opportunity to secure protection from effective competition.

While antitrust may be equivalent to conventional forms of rivalry from the point of view of firms choosing among alternative competitive strategies, the options are not equivalent for the rest of us. Cutting prices or investing resources in some method of nonprice competition generates consumer surplus. Instigating a lawsuit imposes costs on the economy. There are both direct and indirect social costs involved when antitrust is used to subvert competition. Litigation expenditures comprise the bulk of the direct so-
cial costs of rent-seeking through antitrust processes. As noted earlier, these outlays can be astonishingly high. To these costs must be added the expenses incurred by the public antitrust enforcement agencies.

The direct costs of litigation, however, are only a small factor. When faced with an antitrust challenge, the energies of the firm's managers are deflected from efforts to increase productivity or to improve product quality toward issues related to the pending litigation. The attention of the firm's internal legal counsel will be focused on taking depositions, preparing witnesses, supervising responses to subpoenas, and writing legal briefs rather than drawing up contracts with suppliers and customers. On a deeper level, executives and lawyers will be hired for their adeptness in dealing with the antitrust law rather than for their business acumen. Moreover, the priorities of the firm respecting conventional methods of rivalry will be altered in socially costly ways. Managers will hesitate to engage in the types of competitive behavior ("predatory" price-cutting or external growth through merger, for example) that risk the possibility of an antitrust lawsuit. While no estimate of the magnitude of the indirect costs of this sort is possible, they are probably several times the direct litigation costs.

The value of the resources consumed both directly and indirectly as a result of rent-seeking through antitrust processes is a net loss to the economy. Such costs are incurred in wealth redistribution rather than in income-producing activities. It is certainly true that lodging an antitrust complaint against a competitor may generate private benefits for the plaintiff if the rival is subsequently ordered to cease cutting prices, prevented from consuming a merger that would reduce costs, or barred from using some other "unfair" method of competition, but nothing of value is thereby created for consumers. In the limit the total cost of such activities includes both higher prices to consumers and the efficiency losses that result from insulating firms from the forces of effective competition.

It has not yet been systematically shown that most private antitrust cases are anticompetitive. The indications, however, are that the strategic use of antitrust to subvert competition is widespread. If so, Baumol and Ordover were correct when they concluded: "This is a specter that may well dwarf any other concern about the antitrust processes. We ignore it at our peril and would do well to take steps to exorcise it."

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**Selected Readings**


