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On the Pretrial Use of Economics

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Oliver Williamson's advocacy of a greater role for economists pretrial was prescient. This article explains the value of such pretrial intervention (in aligning incentives and encouraging settlement) from law and economics perspectives, and advocates greater use of court-appointed economic experts. The article also offers a brief critical commentary on Williamson's views with respect to predation.

I. INTRODUCTION

Writing in the *Antitrust Bulletin* just over 25 years ago, Oliver Williamson proved to be an early and insightful observer of both antitrust law and antitrust economics and the economics of legal process.[1] Williamson's advocacy of a greater role for economists pretrial in antitrust cases was prescient; that role has steadily grown to the point that today economists are now regularly involved in major antitrust matters (public and private) at the earliest stages.

As an exemplar of the issues raised by an economist's greater role, Williamson offers a discussion of his role in the *Barry Wright Corp. v.*

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[1] Oliver Williamson, *Pretrial Uses of Economists: On the Use of "Incentive Logic" to Screen Predation*, 29 ANTITRUST BULL. 475 (1984).

ITT Grinnell Corp. predation case.[2] Williamson's analysis focuses primarily on section 2 (predation) issues, but does include some commentary on section 1 (collusion) as well. In essence, Williamson's view was that early screening of predation cases could reduce litigation costs by (1) leading to the dismissal of cases in which predation did not make logical sense; and (2) encouraging settlement by more closely aligning the incentives of the parties.

Williamson was writing in the aftermath of Judge Edward Becker's significant opinion in *Matsushita*.[3] Yet, he most likely would not have expected the proper role of economic testimony to be quite as hotly debated as it has since the Supreme Court's *Daubert* decision on the admissibility of expert testimony.[4] Nor, perhaps would he have expected the push for economic testimony to be spurred when the pleading standards were raised in the Court's recent *Twombly* decision.[5]

In this short article, I will elaborate on the primary theme of Williamson's work—the early pretrial use of economic testimony. I begin with commentary on legal process. Following that I comment on the extent to which economic testimony can successfully screen predation cases.

II. LEGAL PROCESS

According to Williamson, earlier exposure to economic assessments of the merits of a case will generate two significant benefits. First,

> it forces the parties and the courts to focus on the economic issues early. . . . An early separation of the wheat from the chaff reduces the likelihood of obscuration at trial stages, which saves time and avoids confusion. Occasionally, an examination of the economic merits may so dramatically clarify the issues that pretrial settlements that would not otherwise be reached can be agreed to. . . .[6]

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[2] Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983).

[3] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986).

[4] Daubert v. Merrell Dow Pharm., 509 U.S. 579 (1993).

[5] Bell Atl. Corp. v. Twombly, 127 S. Ct. 1955 (2007).

[6] Williamson, *supra* note 1, at 476.

In *Barry Wright*, Williamson submitted a memo to the Court on behalf of one of the parties. Williamson's extensive and thorough analysis of the case provided the Court and the parties an analytical roadmap with respect to the core economic issues raised by a prototypical predation case. While Williamson represented one of the parties in this particular matter, it is clear that he was also encouraging a broader role for pretrial testimony by economists as neutral court-appointed experts. There have been a number of prominent occasions in which courts have appointed experts to advise them in significant antitrust cases, but those occasions have been relatively few and far between.[7]

There is no doubt that judges have the authority to appoint economic expert witnesses and to apportion the costs of doing so among the parties under rule 706 of the Federal Rules of Evidence. However, judges have generally been reluctant to do so, perhaps because they believe it will be difficult to find a neutral expert and perhaps because they are worried that the expert rather than the judge will be seen as having determined the ultimate outcome of the case.

In my opinion, neither concern should be seen as prohibitive. Each can be overcome by appropriate judicial management. If the concern is one of finding a neutral expert, there are selection processes that are likely to lead to an expert who is not biased toward one side or the other. I have previously advocated the use of an arbitration model, in which each side chooses an expert (or a list of experts) and the experts from each side agree on an accepted third expert to serve the court (or the expert is chosen by the court from any names that are common to the two lists).[8] Judge Richard Posner supported this particular solution in an article written about a decade ago.[9]

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[7] The most famous instance of a court-appointed expert was undoubtedly Judge Wyzanski's appointment of Carl Kaysen as a clerk in *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

[8] Daniel L. Rubinfeld, *Econometrics in the Courtroom*, 85 COL. L. REV. 1048 (1985).

[9] Richard A. Posner, *The Law and Economics of the Economic Expert Witness*, 13 J. ECON. PERSP. 91 (1999).

Economists do have a range of perspectives on antitrust enforcement, especially when difficult unsettled issues (such as vertical nonprice restraints) are on the table. Some might see these different perspectives as bias, and some might be concerned that the opinions of experts will be influenced by their compensation. While this may be true in some instances, I believe that the process of selecting experts with differing perspectives is the primary driving force that explains the differences of opinions that we see in most cases. Strategic legal positioning during the litigation process will, of course, be important. But, strategy in the selection of experts is even more important. Once experts have been retained, reputation will constrain expert testimony to some extent. Indeed, for some experts, reputational value (both as an academic and as a respected consultant) can be expected to be the single most important motivating factor in the effort put forth by a court-appointed expert.

If the concern is that the expert is likely to determine the outcome of the case, the court needs simply cabin the role of the expert through a clearly specified (ideally, written) set of instructions that describe the scope of the expert's role in the case. In some instances, the expert testimony can be limited to narrow technical issues, while in other cases the role can be limited to pretrial issues such as class certification. And, in still other cases the court-appointed expert can assist the court throughout the trial on the merits.

My own experiences with court-appointed experts have shaped and perhaps reinforced these views. In *Glass Containers Antitrust Litigation*, I was appointed by Judge Ilana Rovner, then a federal district court judge in the 7th Circuit, to assist with the evaluation of issues relating to class certification.[10] I understand that the selection was the result of a search by Judge Rovner for an expert who would provide a balanced view of the case. Furthermore, my role was delineated in written instructions from the court. I provided a written evaluation of the submissions of experts for both sides, and I testified and was available for cross-examination by the parties in a pretrial hearing. Based in part on my evaluation, the court chose not to certify a national class of direct purchasers of glass containers, but did certify

[10] The case was originally brought as *Plaintiffs v. Owens-Illinois, Inc.*, No. 83 C 512, 1989 U.S. Dist. LEXIS 6662 (N.D. Ill. June 5, 1989).

a set of subclasses based on the various functional uses of glass containers.

In *New York v. Kraft General Foods*,[11] Judge Kimba Wood appointed Alfred Kahn to assist in the evaluation of the opposing testimony of the parties' experts through a month-long trial on the merits of the proposed acquisition by Kraft (Post Cereals) of the cereal assets of Nabisco. Professor Kahn served very effectively in a broadly defined role throughout the nonjury trial. In this instance, Professor Kahn was given the opportunity to cross-examine each of the parties' economic experts and to write a separate evaluation of that testimony.

Pretrial settlement was obviously not reached in *Kraft*, while the *Glass Containers* case did eventually settle. In both instances, however, it was clear that the presence of a neutral expert advisor significantly altered the incentives of the parties' experts. Knowing that a skilled neutral observer will be evaluating one's testimony provides a powerful incentive to (1) focus on the most important issues; (2) avoid making irrelevant arguments; and (3) aim for relative balance, rather than overstatement as an advocate for a particular position.

The ultimate prediction that flows from Williamson's insight is that early involvement by a neutral observer will substantially increase the likelihood that the parties will settle the case. Early involvement is likely to encourage expert testimony to focus on core issues and to utilize valid, credible methodologies. This, in turn, is likely to reduce the divergence of opinions of the experts. In some instances, the neutral expert will, in effect, have served as a passive mediator, which is consistent with efforts by courts to encourage settlement through various forms of mediation.[12] More generally, the neutral expert will have the effect of moving the expectations of the parties toward likely trial outcomes. It is well documented in the literature on the economics of discovery that the more closely aligned

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[11] New York v. Kraft General Foods, 926 F. Supp. 321 (S.D.N.Y. 1995).

[12] Various federal court districts have put in place early neutral evaluation of programs whose goal (in part) was to encourage settlements. *See, e.g.*, American Arbitration Ass'n, *Early Neutral Evaluation: Getting an Expert's Assessment*, *available at* http://www.adr.org/sp.asp?id=35761 (last visited May 8, 2010).

the expectations of the parties, the greater the likelihood that a case will settle.[13] To my knowledge this important process point has yet to be evaluated with respect to the appointment of court-appointed experts in antitrust cases.

III. PREDATION

Oliver Williamson's concern with the evaluation of issues relating to section 2 of the Sherman Act clearly predated his article on the pretrial use of economists. His article on franchise bidding in cable television offers one early example, as does his somewhat later article on predatory pricing.[14]

In this early work and in *Pretrial Uses*, Williamson made clear his view that a variety of competitive practices could be used effectively to predate, i.e., to exclude competition in concentrated markets in which there were significant barriers to entry. While not limited to vertical issues, Williamson's commentaries were especially insightful when it came to raising the possibility that various forms of vertical contracting could be used to foreclose competition. To take one recent example, the two-level entry problem, appreciated in Williamson's early work, was cited as a key source of an important barrier to entry into the market for desktop operating systems in *United States v. Microsoft Corp.*[15] In this case, the Department of Justice argued (and the D.C. Circuit agreed) that there was an "applications barrier to entry" caused by the fact that one could not offer a successful operating system without also offering an office suite and other key business and personal software.

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[13] Robert Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435 (1994). *See also* Robert Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and their Resolution*, 27 J. ECON. LITERATURE 1067 (1989).

[14] Oliver E. Williamson, *Franchise Bidding for Natural Monopolies—in General and with Respect to CATV*, 7 BELL J. ECON. 73 (1976), and Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977).

[15] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (en banc). For an extensive discussion of the economics underlying this case, see Franklin M. Fisher & Daniel L. Rubinfeld, U.S. v. Microsoft: *An Economic Analysis*, 46 ANTITRUST BULL. 1 (2001).

Williamson's focus on strategic considerations distinguishes his work from that of the early Chicago school writers whose emphasis tended toward the analysis of static, rather than dynamic markets. Nevertheless, the theme in Williamson's work is a cautious one. In *Pretrial Uses of Economists*, Williamson goes to some length to point out the social costs of type 1 errors in antitrust enforcement—cases in which legitimate procompetitive strategic behavior by firms with substantial market power is mistakenly seen as anticompetitive.

Williamson's analysis of predatory pricing provides perhaps the best illustration of his views on strategic behavior. Williamson's commentary predates *Brooke Group*,[16] but nevertheless contains the essential elements of that important decision. Williamson argues first that there is a necessary logic to a valid predatory pricing (or other predation) claim. According to Williamson, "the merits of predatory pricing claims can be assessed in logical as well as factual respects. Those claims that rely on defective logic are naturally suspect."[17]

Williamson goes further by arguing that if the appropriate logical foundation is not present, the case should not proceed. However, if there remains doubt about the legitimacy of the strategic behavior, Williamson advocates a rule of reason analysis that is tailored to the specifics of the case. Thus, "if it appears that strategic features could be significant, a detailed economic assessment of the relevant facts . . . is needed to evaluate the merits.[18]

Finally, Williamson advocates a substantially more active role for economists at the early stages of the litigation process. With respect to predation, Williamson makes it clear that certain structure presumptions should be met before a case should be allowed to proceed and that economic testimony can be fundamental in evaluating this issue.

With respect to predatory pricing, Williamson points out, for example, that "there is general agreement that fully remunerative

[16] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

[17] Williamson, *supra* note 1, at 478.

[18] *Id.* at 479.

sales, taking all relevant costs into account, are nonpredatory."[19] Williamson offers an insightful analysis of the supply and demand conditions that are prerequisite to a successful predation case, irrespective of whether pricing is the primary concern. Well before the *Brooke Group* decision, Williamson pointed to the need for a plausible recoupment scenario.[20] He also advocates a structural presumption—the firm or firms must have a sufficient market share, and there must be sufficient barriers to entry.[21]

Williamson's demand-side analysis points to the importance of countervailing buyer power. He suggests that "large and perceptive customers will recognize that their interests and the profit calculus upon which the dominant firm relies—which entails sacrifice of immediate profits (low current prices) for future profit gains (high future prices)—are of opposite sign."[22]

Finally, Williamson comments on cases in which collusion is alleged. Applying a similar logic, he points out that it does not make sense for firms to attempt to collude if the industry is one in which "unilateral cheating is easy."[23] Presumably, Williamson would suggest that courts should look with a wary eye at a civil collusion claim under section 1 of the Sherman Act in an industry in which firms were unable to monitor each other's activity or firms were unable to punish those firms that cheated on the collusive agreement.

IV. SUMMING UP

Oliver Williamson's insights into the evaluation of predatory behavior were prescient. So were the implications of those insights for legal process. We can look today at decisions in cases such as *Twombly*

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[19] *Id.* at 482.

[20] *Id.* ("[P]redation is rational only if the sacrifice of current profits can be recouped by increased future profits.").

[21] *Id.* at 483 ("High concentration coupled with high hurdles to entry thus describe the supply-side preconditions for a claim of predation to be taken seriously.").

[22] *Id.* at 484.

[23] *Id.* at 496.

and *Daubert* as having been anticipated and supported by the earlier writings. What remains perhaps is the resolution of a continuing discussion of the proper role of economists in pretrial proceedings, whether as advocates for the parties or as neutral court-appointed experts.

To end on a lighter note, Oliver Williamson is a baseball fan and has on occasion used baseball analogies. In *Pretrial Uses* Williamson comments with respect to strategic behavior that "[b]atters like fat pitches, and competitors like fixed targets. But the rules of the game provide that fastballs, curves, and sliders are all ok. . . . [O]nly unlawful rivalry is objectionable. Spitballs are prohibited. So is predation."[24] I confess that it is a bit difficult to imagine an umpire stopping play to seek the advice of an economic expert as to how to rule on a particular play. However, I can see an invaluable role for an economic expert in helping the parties to plan strategies (witness Michael Lewis's description of the Oakland A's strategy in *Moneyball*[25]) or in managing conditions that encourage competitive behavior among teams in professional baseball. If he is looking for a career change, Olly Williamson gets my vote for the next Commissioner of Major League Baseball.

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[24] *Id.* at 500.

[25] MICHAEL LEWIS, MONEYBALL: THE ART OF WINNING AN UNFAIR GAME (2003).