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ADDRESS

Federalism and the Enforcement of Antitrust Laws by State Attorneys General

THE HONORABLE RICHARD A. POSNER*

I will first offer an analysis—an economic analysis, naturally—of federalism, and I will then apply it to two related questions. The first, to which I will devote the bulk of my attention, is whether state attorneys general should be permitted, as they are under existing law, to enforce federal antitrust laws in suits brought on behalf of the state's residents. The second is whether they should be permitted, as they also are under existing law, to enact and enforce their own state antitrust laws. Although my analysis is primarily theoretical, the Appendix to this paper reports the results of a limited empirical study that I have conducted.

I. SOME ECONOMICS OF FEDERALISM

When the state itself, in its proprietary capacity—for example, as a purchaser of road-building materials—is injured by a federal antitrust violation, its suing the violator for redress is not problematic. Problems arise only when it sues in an essentially public capacity, as a substitute for or a competitor of the federal antitrust enforcement authorities. Serious problems do arise then.

But first, I will frame some thoughts about the theory of federalism. Imagine some industry. We can imagine it composed of a single firm, a monopolist, or, at the other extreme, of fifty separate firms; my reason for choosing the number fifty is obvious. On the one hand, a monopolist would be able to internalize certain costs and benefits that would be externalized under a competitive organization of the industry. On the benefits side are new, imitable inventions and ideas, in which monopoly is a substitute for patents, copyrights, and trade secrets, as methods of internalizing the benefits from innovation. On the costs side are competitive costs that do not generate net social welfare gains, such as advertising and marketing expenditures that primarily affect the market shares of firms selling essentially identical products; manufacturing facilities that have excess capacity; and other respects in which competition creates duplication without fully offsetting benefits.

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On the other hand, the competitive organization of the industry would give consumers more choices (and at lower prices, assuming that the avoidable costs of competition noted above are not too great) and also promote diverse approaches to inventive activity. This element is important to those who believe, as I do, that Darwinian theories of the inventive process, which model it as a trial and error process that is optimized by diversity among inventors in the same way that biological evolution is promoted by genetic diversity, are the best theories that we have of the inventive process.

Now, it may seem that a monopolist could offer whatever product variety consumers wanted and achieve whatever diversity in research and development was optimal—in short, all the benefits that competition affords (except low prices!)—simply by decentralizing its marketing and research activities. But this is incorrect, especially with regard to research. The reason is that no organization can tolerate as much diversity as a competitive market can. There must be a considerable degree of uniformity, of structure, of rules and reporting, of cultural conformity—a considerable degree of, in a word, bureaucracy—in any large organization; it is an imperative of management. Without considerable uniformity it ceases to *be* an organization; centripetal forces dominate. The fact that so many mergers disappoint investors illustrates how combining different corporate cultures under the same roof, like combining different ethnic cultures in the same nation, is an extremely difficult trick to pull off.

This analysis transfers well to the issue of federalism. There are unitary, monopolistic governments such as that of France and until recently the United Kingdom, to speak only of democracies, on the one hand, and, on the other hand, there are federal systems such as that of the United States, Germany, Switzerland, and Canada. The monopolistic governments are “efficient” in the same sense as the monopoly supplier of some good or service; they internalize externalities and, what is actually an aspect of cost internalization, minimize duplication. But they fall down in their encouragement of variety and innovation. France is overcentralized because the imperatives of management limit the degree to which it can achieve, through bureaucratic subdivisions, the benefits of decentralization. In contrast to local and regional government units in a country such as France, U.S. states exhibit considerable variety in the services they offer their residents. This variety reflects both cultural, economic, and demographic differences among the populations of the different states, and the tugs and hauls of competition because it is relatively easy for individuals and especially firms to relocate from one state to another. Emigration from a nation is of course more difficult or costly. Justice Brandeis long ago aptly described the states as isolated laboratories for social experiments.¹ What he meant was that a state could experiment with some novel form of regulation or of configuring the extent or delivery of state services. The results of the experiment would

1. See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

be observed by other states and, if the experiment was successful, it could be emulated by the other states or adopted by the federal government within its domains. There are innumerable examples from our history of social experiments conducted at the state level. These experiments range from early antitrust and regulatory law, "progressive" social welfare legislation, abortion reform, and novel sanctions for sex offenders to voucher systems, the privatization of prisons, and the state welfare reforms in Wisconsin and elsewhere that led up to the national welfare reform of the 1990s. The analogy to Darwinian theories of innovation is very close.

But the considerable advantages of federalism coexist with considerable disadvantages, namely negative externalities, external costs as distinct from external benefits, that tend to be greater than the negative externalities created by competitive markets. Individuals and even firms cannot move from state to state with the same ease with which they can switch from buying one product to buying another. To an extent, states have a captive market, and as a result, there is less competitive pressure on them than there is on private business firms. States also have opportunities to export costs in much the same way that a polluting firm can export costs in the absence of legal liability. For example, a state that contains valuable mineral resources can, by imposing a severance tax on them, shift some of the costs of the state's government from the state's taxpayers to the consumers of the resources in other states or nations, assuming demand for the resources by nonresidents of the state is not perfectly elastic. State taxes on interstate users of its highways could have similar effects and likewise state tort rules slanted in favor of residents. For example, a rule that exempted negligent in-state manufacturers from liability to nonresidents injured by their negligence, or that imposed strict liability on nonresidents who injured state residents however careless the residents were, can operate to export costs. State antitrust suits, which are a form of tort suits, can have the same result.

But, just as there are legal rules against unwarranted cost externalization by private firms, for example, rules against pollution (or at least pollution that is not cost justifiable), so also, Congress has the power to prevent states from trying to shift the costs of government to other states or other costs from the shoulders of residents to those of nonresidents, by legislating under the Constitution's Commerce Clause. And the Supreme Court has long interpreted the Commerce Clause to forbid of its own force, without need for congressional legislation, unreasonable state burdens on interstate commerce, which means, approximately at least, shifting costs without justification from local taxpayers to taxpayers in other states or in foreign nations or more broadly, from residents to nonresidents. This "negative" or "dormant" interpretation of the Commerce Clause is enforced by the courts, mainly the U.S. Supreme Court, and is (one is tempted to say, therefore) rather toothless in application because of the difficulty of determining by the methods of litigation either the costs of government services or the incidents of the taxes and other measures to which a state might resort in an effort to recoup or shift those costs.

It is tempting, to return to an earlier point, to suppose that a much cleaner solution to the problem of optimal decentralization of American government than federalism would be a unitary government that, like any efficient large enterprise, organized itself into divisions, subdivisions, etc. on functional or geographical (or both) lines, designed to strike the optimal balance between the advantages of centralization and those of decentralization.² But this would be unsatisfactory for the same reason that a monopolist's decentralization of its operations would not generate the same product variety and innovative progress as would a competitive organization of the industry. The unitary government would have to insist upon considerable uniformity among all its divisions and subdivisions, as it would otherwise lose control. The large differences among the political cultures and institutions of the fifty states would be unthinkable if there were no states, but merely regional and local offices of a unitary federal government.

Against this it can be argued that decentralization can have negative effects, for example, by increasing the likelihood of corruption, because of the loss of control over subordinate officials. Further, it can be argued that it would be pure accident if our federal system represented the optimal amount and pattern of decentralization because it is a historical accident that the states have the size, population, and configuration that they do.³ The case for federalism remains somewhat conjectural.

II. STATE ANTITRUST ENFORCEMENT

A. *Parens Patriae*

I turn now to antitrust enforcement by the states, beginning with the authority conferred in 1976 on state attorneys general by the Hart-Scott-Rodino Antitrust Improvements Act,⁴ to bring suits (*parens patriae* suits) on behalf of the residents of their states under federal antitrust law. The effect of the Act, in principle at least, is to make public enforcement of federal antitrust law a competitive rather than a monopoly "market." I shall consider the pros and cons of this approach in light of the theory of federalism sketched in Part I.

The first thing to note is that the state attorneys general are not the states. They are separately elected from the governor. This is significant in three related respects. First, state attorneys general are politicians, that is, they are elected rather than appointed officials. Second, the natural ambition of a politician who holds high state office is to be elected governor; hence, there is often a built-in tension between the attorney general and the governor of a state as well as an incentive on the part of the attorney general to bring suits that confer a

2. See Frank B. Cross, *The Folly of Federalism*, 24 CARDOZO L. REV. 1, 18–29 (2002).

3. See *id.*

4. 15 U.S.C. § 15c (2000).

political benefit on him, such as suits that benefit powerful local business or other constituencies. Third, because the attorney general is not part of the governor's administration, he lacks leverage in seeking appropriations from the state legislature. As a result, state attorneys general are chronically underfunded. They cannot afford large staffs and so they cannot reap the benefits of specialization. Nor can they afford to hire top-quality lawyers. These resource-related handicaps are particularly serious in a highly technical, expert-witness-intensive, specialized field of law such as federal antitrust law.

The coalescence of these factors suggests a strategy for a state attorney general that is in fact observed. The strategy consists in bringing high-profile lawsuits that attract publicity to the attorney general and that promote the interests of politically influential state residents, including corporations that have headquarters or extensive operations in the state, at the expense of nonresidents, including nonresident competitors of resident enterprises.⁵ The strategy is constrained, however, by the fact that the resources available for such litigation are likely to be very limited unless the litigation has a realistic prospect of generating a large monetary judgment or settlement for the state, or unless several states join in the litigation, as they frequently do,⁶ enabling a pooling of resources. The latter is often the more feasible method of economizing on litigation expenses even when damages are the relief sought. The reason is that judgments or settlements obtained in *parens patriae* litigation are generally distributed to the state residents on whose behalf the suit was brought, and, if there is money left over, to charities designated by the state attorney general,⁷ although the court may award attorney's fees to him.

It is easy to see why antitrust *parens patriae* suits might be attractive to state attorneys general. Firms headquartered or operating within the state are likely to face competition from nonresidents and they will be grateful if the state's attorney general incurs the expense of suing those competitors. A state attorney general may also have somewhat greater credibility with the courts than would a competitor plaintiff. And major antitrust violations are likely to have effects in multiple states, facilitating joint action and, therefore, resource pooling by state attorneys general. What is more, as shown by the Microsoft case, if the U.S. Department of Justice brings an antitrust suit, the state attorneys general may be able to take a free ride on the Department's investment in the litigation, by bringing parallel suits that are then consolidated with the Justice Department's suit.⁸

The antitrust strategy of state attorneys general that I have just sketched

5. For some statistical evidence, see Table 3 in the Appendix.

6. For some statistical evidence, see Table 2 in the Appendix.

7. See Susan Beth Farmer, *More Lessons from the Laboratories: Cy Pres Distributions in Parens Patriae Antitrust Actions Brought by State Attorneys General*, 68 *FORDHAM L. REV.* 361, 391-405 (1999).

8. *United States v. Microsoft Corp.*, 253 F.3d 34, 47 (D.C. Cir. 2001).

obviously has a potential to generate socially perverse consequences. The use of the antitrust laws to harass competitors is an old story but a true one, and given the political incentives of state attorneys general, the risk is great that in deciding whether to bring an antitrust suit against a competitor of a resident enterprise, a state attorney general will not be scrupulous in the exercise of his enforcement discretion and will bring and press the suit even if unconvinced of its merit. This is a form of protectionism. In addition, I worry that state attorneys general will try to channel the moneys recovered in their suits to charitable uses that advance their political agendas.

And if, as is common (as I noted earlier), there are multiple state plaintiffs, there will be coordination costs that will make it more difficult to settle the case than it would be if there were only a single plaintiff. This was a factor in the length of time that it took to settle the Microsoft litigation, where there were initially eighteen state plaintiffs as well as the U.S. Department of Justice. Indeed, it is not fully settled, because some of the state plaintiffs refused to settle and are appealing the district judge's rejection of their position.⁹

So there is a considerable downside to *parens patriae* antitrust suits, but we should consider whether there may be a significant upside. I think not. Because of the resource constraints that I have mentioned, it is unlikely that state attorneys general will be sources of innovative antitrust doctrines or methods of proof; in fact, I know of no examples where they have been. (A separate question, which I will discuss shortly, is the contribution to antitrust thinking made by the enactment or interpretation of state antitrust laws.) In principle, by offering competition in public enforcement of federal antitrust laws to the U.S. Department of Justice, the state attorneys general keep the Department on its toes and offer alternatives that a monopoly would foreclose. When the 2000 presidential election resulted in a change in personnel in the Justice Department

9. In an article defending the role of state attorneys general in federal antitrust litigation, the former chief of antitrust in the New York Attorney General's office makes certain representations concerning my activity in the mediation of that case. See Harry First, *Delivering Remedies: The Role of the States in Antitrust Enforcement*, 69 GEO. WASH. L. REV. 1004, 1032–34 (2001). His representations are inaccurate, except in one respect: I was indeed appalled by the unreasonable and irresponsible position taken by several of the state attorneys general in the mediation. He is incorrect, however, in stating that I "did not deal directly with the states until near the end of the mediation process." *Id.* at 1032. I did not deal much with Mr. First because he attended only one of my meetings with the plaintiffs' side of the litigation, but I dealt continuously with Tom Miller, the Attorney General of Iowa, who was the lead representative of the state attorneys general in the mediation. Thus it is also false that "the states were not actively consulted for a substantial part of the mediation process." *Id.* at 1033. He says that I apparently "thought that the mediation was hopeless once it was clear that the states intended to play an active role, coming forward with views somewhat at variance with the Justice Department's." *Id.* At the last moment, the states upped the ante, making demands that it was plain that Microsoft would never accept. He accuses me of "impatience" in terminating the mediation when the states unexpectedly escalated their demands. *Id.* Yet, it was only after four months of almost full-time mediation that, faced with the intransigency and incompetence of the states, I decided the case would not settle and threw in the towel.

that resulted in a willingness to settle the case on terms more favorable to Microsoft than the Clinton Administration had been prepared to do, several of the states, as I noted earlier, refused to accede to the settlement and thus offered to the courts a competitive alternative to the Justice Department.

But there are four reasons to doubt the value of such competition. The first is its one-way character. The state attorneys general can only offer harsher anti-trust enforcement than the Justice Department. They cannot, by not suing, offer the courts a gentler alternative to the Department's enforcement policies because their decision not to sue does not bind anyone. They can pile on, but they cannot remove the Department from the pile. It is as if the only permitted competition with General Motors is to make cars with more horsepower than GM cars. The danger is that interstate businesses will be forced to conform their business practices to "the most restrictive state interpretation of federal antitrust law."¹⁰ In fairness to the state attorneys general, their national association has issued horizontal-merger and vertical-restraint guidelines, thus providing some uniformity of enforcement policy; but, not so commendably, the guidelines are harsher than the corresponding guidelines of the Justice Department and the Federal Trade Commission.¹¹

Second, even if the states could not bring *parens patriae* antitrust suits, private individuals and firms harmed by antitrust violations would be able to bring suits under federal antitrust law for redress of the injury. Competitors and customers of Microsoft are not bound by the Justice Department's settlement and can—and have—sued Microsoft on their own.¹² The class action device enables aggregation in a single suit of antitrust injuries too slight to warrant the expense of individual suits. The *parens patriae* suit is in effect a class action, and while class actions have plenty of problems, I know of no evidence that *parens patriae* suits solve them.

Third, there is competition in antitrust enforcement at the federal level by virtue of the overlapping jurisdictions of the Justice Department and the Federal Trade Commission; increasingly, there is competition at the international level as well.

Fourth, despite the potential bonanzas that *parens patriae* damages suits might seem to offer, the limited funding of state attorneys general has, perhaps

10. Donald L. Flexner & Mark A. Racanelli, *State and Federal Antitrust Enforcement in the United States: Collision or Harmony?* 9 CONN. J. INT'L L. 501, 532 (1994) (citing Ernest Gelhorn, *States' Rights in Regulation of Local Conduct*, 2 ANTITRUST REP. 6 (1989)).

11. See National Association of Attorneys General, *Antitrust Protocols*, at <http://www.naag.org/issues/issue-antitrust-protocols.php> (discussing NAAG guidelines and comparing them to guidelines issued by the DOJ and the FTC). The NAAG has been called "a modern heir to the populist tradition" of antitrust law. Jonathan Rose, *State Antitrust Enforcement, Mergers, and Politics*, 41 WAYNE L. REV. 71, 126 (1994).

12. See generally Brier Dudley, *Class-Action Settlements in D.C., 5 States for Microsoft*, SEATTLE TIMES, Oct. 29, 2003, at E1.

in conjunction with other factors, resulted in an extraordinary paucity of anti-trust *parens patriae* suits.¹³

To summarize, nothing in the theory of federalism lends support to authorizing state attorneys general to bring *parens patriae* suits under federal antitrust law. But the case against such authorization would be weakened if state attorneys general were appointed rather than elected officials, a reform that is independently desirable.

B. State Enforcement of State Antitrust Laws

Let me move now to the question of allowing states to have their own antitrust laws. Here the case for federalism, for an affirmative answer, is stronger. For one thing, there is no necessary connection between a state antitrust law and enforcement by the state attorney general because private enforcement of state antitrust law is possible and indeed common. For another thing, if antitrust violations that did not affect interstate or foreign commerce were not actionable under state law, there would be a law enforcement vacuum because the Commerce Clause of the federal Constitution would not authorize federal action against such violations either. To that extent, state antitrust law is secure. But Congress could preempt state antitrust law insofar as it is applicable to interstate or foreign commerce; such preemption, in areas as varied as securities law and pensions, is commonplace and of unquestioned constitutionality. We should consider the pros and cons of it.

On the one hand, dual enforcement, as I remarked earlier in reference to state enforcement of federal antitrust law, provides a competitive alternative to the U.S. Justice Department's monopoly of antitrust enforcement. But, as we have also seen, the Department would not have a monopoly even if there were no state antitrust laws because of private suits under federal antitrust law and also because of the FTC. However, unlike the case of dual or multiple enforcement of the same laws, state antitrust law provides an opportunity for doctrinal competition and the states have taken that opportunity, notably in the widespread rejection by the states of the *Illinois Brick* doctrine.¹⁴ That doctrine, an interpretation of federal antitrust law by the U.S. Supreme Court, precludes antitrust suits by indirect purchasers, for example, consumers who purchase from dealers or distributors that are direct purchasers from antitrust violators and that pass on much of the overcharge caused by the violation to their own purchasers, that is, consumers. Although I personally think the *Illinois Brick* doctrine is sound, this is far from certain; its contours moreover are controver-

13. For some statistical evidence, see Table 1 in the Appendix.

14. For an outdated list of the rejecting states, see *California v. ARC American Corp.*, 490 U.S. 93, 98 n.3 (1989). The doctrine itself was announced in *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 745-46 (1977).

sial and it is valuable to have diversity and experimentation in this area, from which a consensus may someday emerge.

But, there is a downside to permitting states to reject *Illinois Brick* and that is the danger of double recovery. In a suit by direct purchasers under federal antitrust law, there is no passing-on defense; that is the *Hanover Shoe* corollary of *Illinois Brick*.¹⁵ Suppose the total overcharge to direct purchasers is \$1 million and of this \$500,000 is passed on to indirect purchasers. The total damages are only \$1 million (\$3 million after trebling), but if direct purchasers sue under federal law and indirect purchasers sue under state law, the defendant may be forced to pay total damages of \$4.5 million after trebling. I assume, however, that the courts would hold that an antitrust defendant cannot be forced to pay total damages in excess of three times the total cost that he has imposed, which is to say the sum of the portion of the overcharge that the direct purchasers did not pass on and the portion that was passed on to indirect purchasers.¹⁶

Given that most antitrust enforcement nowadays is private, the significance of state antitrust law that overlaps with federal law is not so much multiple suits against the same defendant as multiple theories in the same case, to the extent that federal and state antitrust laws differ. This form of duplication is relatively costless. The *Illinois Brick* issue is an exception because rejection of the doctrine of that case enables additional suits. It is an exception that has both an offsetting benefit in constructive legal competition and a cost in potential overdeterrence. I would be inclined, therefore, to forbid the states to apply their antitrust laws to antitrust violations that occur in or affect interstate or foreign commerce.¹⁷ I am even more convinced that Congress should repeal the provision of the Hart-Scott-Rodino Act that authorizes *parens patriae* antitrust suits by the states,¹⁸ although the small number of these suits makes repeal a low-priority item. As a second-best solution, I would like to see state attorneys general converted from elected to appointed officials. But this is not, I hasten to add, because I expect governors to be less politically motivated than other elected officials, but merely because attorneys general would exercise some discretionary authority even if they were appointed, and it would be exercised in a more professional manner if they were not politicians because their antitrust enforcement activities would be better funded, which I hope would increase the quality of the enforcement.

15. See *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968).

16. See Stephen Calkins, *An Enforcement Official's Reflections on Antitrust Class Actions*, 39 ARIZ. L. REV. 413, 427 n.79 (1997); Ivy Johnson, *Restitution on Behalf of Indirect Purchasers: Opening the Backdoor to Illinois Brick*, 57 WASH. & LEE L. REV. 1005, 1037 (2000).

17. The case against permitting states to bring enforcement actions under either state or federal law is even greater in the case of international transactions. See Edward T. Swaine, *The Local Law of Global Antitrust*, 43 WM. & MARY L. REV. 627, 756-85 (2001).

18. 15 U.S.C. § 15c(a)(1) (2000).

APPENDIX. EMPIRICAL ANALYSIS

I have tried to collect data on the actual experience of the states' exercise of its authority to bring federal antitrust *parens patriae* suits. This is not easy to do, because the state attorneys general do not report such data, but I believe that my Westlaw search has recovered virtually all the cases.

Notice first, in Table 1, how few antitrust *parens patriae* suits have been brought: an average of roughly one and a half per state over the entire twenty-seven year period since the enactment of the Hart-Scott-Rodino Act. This paucity of suits makes it unlikely that the *parens patriae* power has much significance for the enforcement of federal antitrust law.

Table 1. Federal Antitrust Suits Brought by State Attorneys General under *Parens Patriae* Authority

Year Table			
	<=1976	11	14.3%
>1976	<=1980	7	9.1%
>1980	<=1985	12	15.6%
>1985	<=1990	18	23.4%
>1990	<=1995	15	19.5%
>1995	<=2000	7	9.1%
>2000	<=2005	7	9.1%
		77	100.0%

As shown in Table 2, roughly a third of these suits, which I call "multi-state," are brought by more than one state's attorney general.

Table 2.

Single-State/Multi-State		
Single-State	53	68.8%
Multi-State	24	31.2%
	77	100.0%

Finally, in Table 3 we see that in a little more than a third of the cases, all the defendants are residents of the plaintiff state(s). And in almost half of the cases, none of the defendants is a resident. These data support my conjecture that *parens patriae* litigation is a method of protecting resident companies from competition from nonresidents.

Table 3.

Portion of Defendants Residing within Plaintiff State(s)		
Overall		
All	29	37.7%
Some, but not All	12	15.6%
None	36	46.8%
	77	100.0%
Single-State Litigation		
All	24	45.3%
Some, but not All	5	9.4%
None	24	45.3%
	53	100.0%
Multi-State Litigation		
All	5	20.8%
Some, but not All	7	29.2%
None	12	50.0%
	24	100.0%

Further details of the empirical study are available from me on request.

