

# Indirect Antitrust Enforcement



Barak Orbach

 THE UNIVERSITY  
OF ARIZONA

# Direct vs. Indirect Enforcement

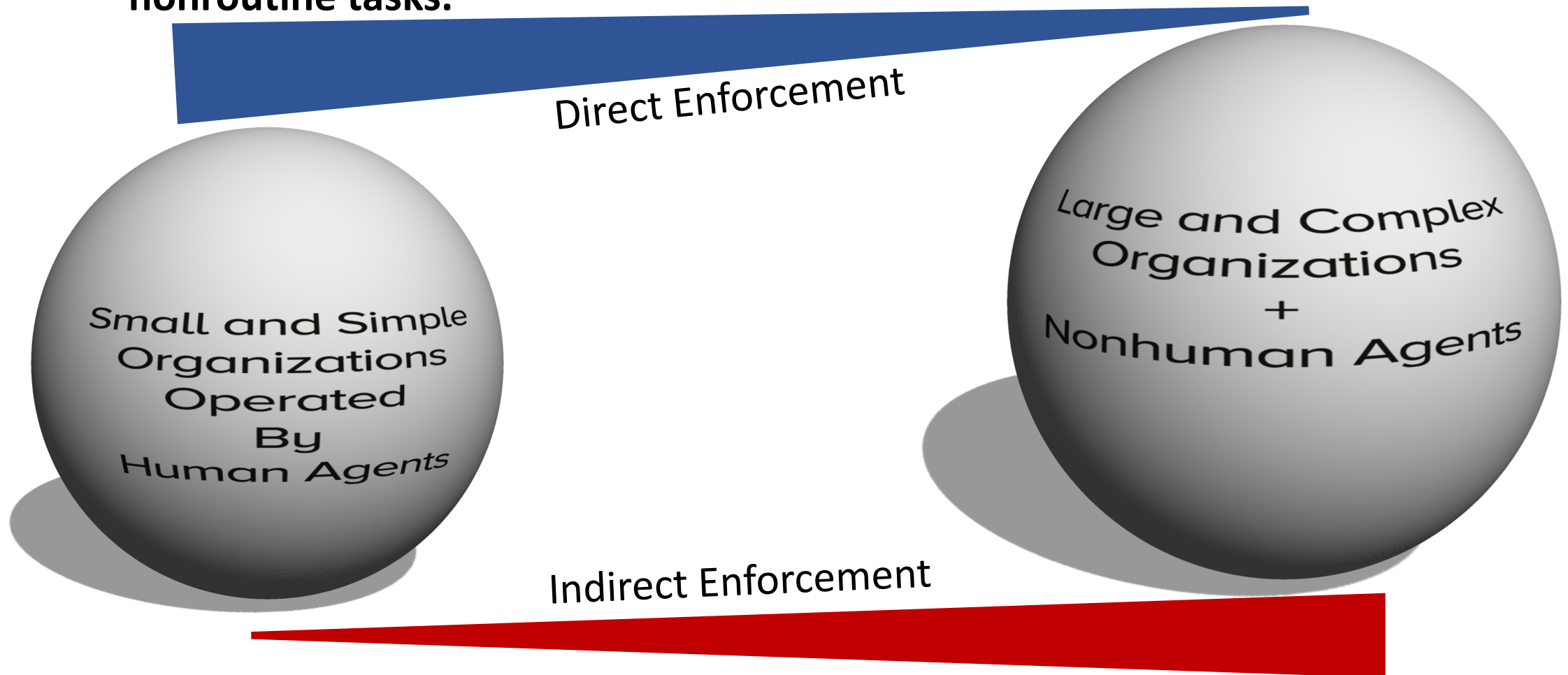
- ❖ **Direct Enforcement:** Enforcement actions intending to hold firms and individuals accountable for their participation in alleged violations.
- ❖ **Indirect Enforcement:** Enforcement actions intending to hold firms and individuals accountable for failures to maintain compliance and failures to report about alleged violations.

## Examples

- Vicarious liability.
- Oversight liability under corporate law.
- Enforcement policies that factor the effectiveness of implemented compliance programs.

# Observations

1. The effectiveness of the direct/indirect enforcement modes is loosely related to organizational size, organizational complexity, and automation of nonroutine tasks.



# Observations

1. The effectiveness of the direct/indirect enforcement modes is loosely related to organizational size, organizational complexity, and automation of nonroutine tasks.
2. **Enforcement policies, antitrust policies included, have been (slowly) shifting toward a growing reliance on indirect enforcement measures.**

# Three Key Factors

1. Organizational Culture
2. Decentralized Control and Diffused Responsibilities
3. Profitable Violations

# 1. Organizational Culture

**Definition:** A maze of formal and informal norms, beliefs, responsibilities, and values that are understood by insiders as *“the way we do things around here.”*

- ❖ Formal policies are observable and verifiable; informal norms may be inferred.
- ❖ Compliance policies tend to be formal, while noncompliance norms tend to be informal.
  - Misalignment of formal policies and informal norms.
  - Tensions between performance goals and compliance policies often foster noncompliance norms.

## 2. Decentralized Control and Diffused Responsibilities

- ❖ A byproduct of size and operational complexity.
- ❖ In decentralized firms, information is communicated horizontally and vertically (upward and downward) through a hierarchy of agents.
- ❖ The architecture of communication channels permits misalignment of performance goals and compliance policies.
  - Willful blindness at the top.
  - Rogue agents.

### 3. Profitable Violations

- ❖ There is an inherent tension between **performance goals** and **compliance** with antitrust law.
  - Unlawful (or unethical) acts may lower the costs of performance.
- ❖ This tension creates concerns that ***reward expectations*** may motivate violations.
  - 👉 *The question is whether the firm adequately calibrates reward expectations to maintain and promote compliance.*

### 3. Profitable Violations

*The calibration of reward expectations is always imperfect.*

- The formation of expectations varies across agents.
- Entity actions/decisions are often products of a process (a set of actions and decisions).
- Moral hazard: teamwork and multitasking.

### 3. Profitable Violations

***Should courts and agencies evaluate the adequacy of formal reward systems and informal factors that shape agents' expectations?***

- The business judgment rule (“BJR”).
- Alleged legitimacy of profitable violations.
- The distinction between aggressive competitiveness and anticompetitive acts isn't sharp.

### 3. Profitable Violations

*Should courts and agencies evaluate the adequacy of formal reward systems and informal factors that shape agents' expectations?*

- The business judgment rule (“BJR”).
  - The BJR applies to D&O, not firms.
  - The BJR isn’t an absolute defense; it is a presumption that D&O’s decisions and actions were **informed** and made in **good faith**.

### 3. Profitable Violations

*Should courts and agencies evaluate the adequacy of formal reward systems and informal factors that shape agents' expectations?*

- The business judgment rule (“BJR”).
- **Alleged legitimacy of profitable violations.**
  - The theoretical notion of “efficient violations” isn’t (and has never been) a defense.

### 3. Profitable Violations

*Should courts and agencies evaluate the adequacy of formal reward systems and informal factors that shape agents' expectations?*

- The business judgment rule (“BJR”).
- Alleged legitimacy of profitable violations.
- **The distinction between aggressive competitiveness and anticompetitive acts isn't sharp.**
  - Distinctions often blur.

# Application: Digital Platforms

(1) culture; (2) decentralization; (3) profitable violations

## ***A marketplace + specific characteristics***

- Scale + Blitzscaling
- Big data and machine learning
- Search and matching mechanisms
- R&D is an operational element

# The Slow Trend

## Big Picture

- The antitrust impulse is (and has always been) about business size.
  - The Second Industrial Revolution (1870-1914): The formation of anti-trust law.
  - The digital revolution (mid-1970s-?): The present populist surge.
- How do (or should) antitrust policies treat scale and scope?
- Both “revolutionary” periods: jurisprudence and public sentiments moving in opposite directions.

# The Slow Trend

## ***The Electrical Antitrust Cases (1961)***

- The Electrical Conspiracy (heavy electrical equipment).
- Criminal prosecution of 29 firms and 45 mid-level executives.
- 2,233 private lawsuits.

# The Slow Trend

## ***The Electrical Antitrust Cases (1961)***

### Pre-Sentencing Statement

- The government was “unable to uncover probative evidence” that could secure convictions “of those in the highest echelons of the corporations.”
- The individual defendants “were torn between conscience and an approved corporate policy with rewarding objectives.”
- The “real blame” was at “the doorstep of the corporate defendants and those who guide[d] and direct[ed] their policy,” and that “one would be most naïve . . . to believe that . . . [the] facts were unknown to those responsible for the conduct of the corporation.”

# The Slow Trend

## ***Graham v. Allis-Chalmers* (Del. 1963)**

- Allis-Chalmers' "operating policy" rested on decentralization "by the delegation of authority to the lowest possible management level capable of fulfilling the delegated responsibility."
- The division's manager "made it clear to his staff as well as representatives of Allis-Chalmers' business competitors that it was the firm policy . . . that ruthless price cutting should be avoided."

# The Slow Trend

## ***Graham v. Allis-Chalmers* (Del. 1963)**

### Findings and Ruling

- The organizational size and complexity of Allis-Chalmers prevented effective supervision.
- The directors were “entitled to rely on the honesty and integrity of their subordinates.”
- The directors had no reason to suspect that employees were engaging in unlawful activities.
- “Absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage.”

# The Slow Trend

## 1970s

- A Reorientation of “Corporate Rights” and Antitrust

## 1980s

- The Duty of Care; Smith vs. Van Gorkom (1985)
- Exculpatory Clauses

# The Slow Trend

## 1990s

- Federal Enforcement Policies
- Oversight Liability; Caremark (1996)
- The *Microsoft* Cases

## 2000s

- Accounting Scandals; SOX
- The Great Recession
- Refined Formulation of Oversight Liability (bad faith = conscious disregard of fiduciary obligations)
- Renewed Fears of Bigness

# The Slow Trend

## 2010s

- Growing public pressures to (1) increase scrutiny of large businesses, and (2) hold executives accountable for corporate wrongdoing.
- Renewed political salience of antitrust.
- Rapidly growing recognition of the significance of organizational culture.

# The Slow Trend

## 2020s

### Starting Point

- Public sentiments and political narrative are hostile toward corporations and executives.
- Federal and state courts are protective of corporate defendants and executives.

# Conclusion

**Indirect Enforcement:** Enforcement actions intending to hold firms and individuals accountable for failures to maintain compliance and failures to report about alleged violations.

*Traditional vs. Modern Corporation*

# Conclusion

- A growing understanding that indirect enforcement is necessary to promote culture of compliance.
- Federal and state courts are skeptical of the soundness of indirect enforcement.
- A slow development of indirect enforcement measures. Public sentiments and corresponding political rhetoric are likely to accelerate the trend.

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