Indirect Antitrust Enforcement
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.
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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.