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Corporate Governance and Competition Policy

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Introduction

Corporate governance law addresses the misaligned incentives between officers and directors of publicly-owned companies and their shareholders, and how this can lead to the destruction of shareholder value. Antitrust law governs the interaction between corporations and other economic actors in the marketplace and prohibits and penalizes anticompetitive agreements, unilateral conduct which unreasonably injures competition, and mergers and acquisitions which may substantially lessen competition.

This article explores the puzzling lack of meaningful interaction between these two fields of law which govern the internal and external operations of key economic players in our economy. While a handful of commentators have lamented the lack of a closer organic connection between these two bodies of law, most do not even notice. This article goes beyond the conventional disconnect and discusses how to create a more unified approach to two key areas of business law in order to promote the interests of both shareholders and consumers in a more systematic and meaningful way.

In order to better draw the links between the two fields and create an ongoing conversation between different fields, different working professionals, different types of expertise, and even different languages, I proceed as follows. In Parts I and II, I briefly describe the traditional view of both the scope and content of corporate governance and antitrust law. In Part III, I then offer an overview of why there has been little overlap or interaction between these critically important bodies of business law. Part IV shows why and how we can do better. I examine five areas of antitrust law where a greater knowledge of,

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and appreciation for, the modern learning in corporate governance law would provide for both better competition and corporate governance law and policy.

I begin Part IV with an overview of corporate compliance and the unfortunately limited role that corporate governance law plays in ensuring lawful behavior. I then look at interlocking directorates, the one provision of the Clayton Act that directly addresses corporate governance concerns. Second, I analyze the critical issue of corporate compliance and cartel behavior. Third, I discuss the more nuanced interaction between antitrust enforcement and corporate governance for other types of agreements between competitors which may sometimes, but not always, violate antitrust law's rule of reason. Fourth, I focus on merger policy where a better understanding of corporate governance and corporate finance literature would provide a roadmap for identifying certain categories of transactions which neither promote shareholder interests nor efficient market competition. Finally, I examine the broader question where corporate governance principles will, of necessity, continue play its currently limited role in ensuring lawful unilateral company behavior.

My conclusions begin the process of how to do better. Certain of the changes fall on the corporate governance side including greater duties and liabilities for officers and directors to prevent harmful and illegal conduct that injures shareholders. Other changes fall on the antitrust side of the fence including a greater skepticism for claims of synergies and efficiencies in certain categories of mergers that have proven time and time again to do nothing to enhance shareholder value except when competition is harmed. But the most important change will be a greater willingness for practitioners and policymakers to more directly communicate and coordinate so corporate actors can pursue legitimate strategies to build value for shareholders and prevent unlawful anticompetitive behavior and, at the same time, not pursue more dubious strategies that currently fall between the cracks of both bodies of law.

I. The Birth of Corporate Governance

The Modern Corporation and Private Property is the most influential book in the field of corporate governance.¹ It analyzes how managers and directors of large corporations often act in their own

¹ ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1933).

best interests rather than the best interests of the shareholders who are the real owners of the company. This important book was written in 1933 by Adolph Berle, a professor of corporate law at Columbia University, who also worked for President Roosevelt and the New Deal in numerous capacities.² His co-author was Gardiner Means, an economist at Harvard University who did much of the empirical work for the project.³

The book analyzed how corporations had evolved from the 19th century where they were primarily small operations owned and operated by an identifiable number of individuals, often family members.⁴ By the early 1930s, corporations were vastly larger and more powerful enterprises with an enormous number of shareholders who bought and sold their shares on stock exchanges.⁵ Typically no one shareholder owned more than a tiny fraction of the shares of the company.⁶

Berle and Means introduced the concept of the separation of ownership and management to describe the modern corporation where the real power lay in the hands of managers and boards of directors who typically owned only small amounts of stock in the company.⁷ This change meant that ownership changed from active to passive.⁸ But it also meant that the form of the wealth that ownership conferred was more liquid.⁹

The small number of insiders (managers and directors) had greater knowledge and different incentives than the large number of outsiders (the shareholders) and could operate the company for their own benefit, potentially harming the shareholders and the corporation itself. The actual power within the corporation lay with those who appointed the directors, typically senior management themselves.¹⁰

² For a succinct biography of his public service see <http://www.bookrags.com/biography/adolf-augustus-berle-jr/>.

³ BERLE & MEANS, *supra* note 1, at preface.

⁴ *Id.* at 66.

⁵ *Id.* at 67.

⁶ *Id.* at 68. This is true in most countries, but most prevalent in the United States. JONATHAN A. MACEY, CORPORATE GOVERNANCE 3 (2010).

⁷ BERLE & MEANS, *supra* note 1, at 68. A number of these themes had been previously introduced by Berle in an earlier article. A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

⁸ BERLE & MEANS, *supra* note 1, at 66.

⁹ *Id.* at 67.

¹⁰ Other aspects of the separation of ownership and control came through legal devices like pyramiding, the issuance of non-voting shares, excessively weighted

The effective result was a self-perpetuating management which often pursued its own interests rather than those of the true owners of the corporation.¹¹ Although Berle and Means did not use this term, later writers referred to this as the agency cost problem.¹² Thus, the field of corporate governance was born to consider appropriate ways to cure or limit the agency cost problem in the modern public corporation.

Berle and Means termed this a problem of “economic governance.”¹³ The book argued for more voting rights for shareholders, more disclosures by management, and other controls for the benefit of the shareholders.¹⁴ The authors also proposed a broader social role for the corporation as a key institution in the modern economy and society.¹⁵

The influence of Berle and Means cannot be understated. It is probably the most cited treatise in corporate law. It has been cited thousands of times in the academic literature and has been credited as the inspiration of much of modern corporate law, securities regulation, the shareholder democracy movement, the market for corporate control, incentive based pay schemes for executives, and most other legal proposals to address the conflicting incentives between corporate insiders and shareholders.

For example, there is a direct relationship between the concerns of Berle and Means and the two long standing duties fiduciary duties imposed on corporate directors; the duty of care and

voting shares, and voting trusts and more real world concerns where even a minority interest in a large corporation could yield effective control. *Id.* at 70.

¹¹ *Id.* at 87, 122.

¹² Murray Weidenbaum & Mark Jensen, *Introduction to the Transaction Edition*, in ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* ix (10th printing 2009); MACEY, *supra* note 6, at 2; Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

¹³ BERLE & MEANS, *supra* note 1, at 125.

¹⁴ *Id.* at 248.

¹⁵ *Id.* at 309-13. *See also* ADOLF A. BERLE, *POWER WITHOUT PROPERTY* 120 (1959); ADOLF A. BERLE, *THE 20TH CENTURY CAPITALIST REVOLUTION* 104-05 (1954)(each continuing theme of societal accountability of public corporations). *See generally* William M. Bratton & Michael L. Wachter, *Tracking Berle’s Footsteps: The Trail of The Modern Corporation’s Last Chapter*, 33 SEATTLE L. REV. 849 (2010); William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolph Berle and The Modern Corporation*, 34 J. CORP. L. 99 (2008)(emphasizing Berle’s evolving goals within *The Modern Corporation* and over time beyond shareholder primacy).

the duty of loyalty.¹⁶ “Good faith” is a subset of both duties, as all directors must act in good faith in performing their duties.¹⁷

The *duty of loyalty* requires that directors consider the interest of the corporation over any personal interests so that they do not profit improperly at the corporation's expense and avoid self-dealing.¹⁸ This duty essentially aims to prevent conflicts of interest, self-dealing between directors and the corporation which injure shareholders, and other conduct which exacerbates agency costs.

The *duty of care* generally requires that directors act in good faith and with the degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances.¹⁹ In Delaware, and many other states, directors are presumed to have made informed, rational decisions in an honest and well-meaning way to further their business.²⁰ This insulates directors from judicial review of their decisions and shields them from personal liability. This presumption rests on the understanding that directors act on a disinterested, informed, and good faith basis.

Critical to understanding these duties is the business judgment rule. The business judgment rule is a “presumption that the Board acted independently, with due care, in good faith and in the honest belief that its actions were in the stockholders’ best interests.”²¹ Under the business judgment rule, courts will not second guess a board decision or substitute its own views if the decision of the board can be attributed to “any rational business purpose.”²² The presumption is

¹⁶ *In re Caremark Int’l, Inc. Deriv. Litig.*, 698 A.2d 959 (Del. 1996). See generally, JAMES A. FANTO, *DIRECTORS’ AND OFFICERS’ LIABILITY* (2d ed. 2007). There remains a dispute in the literature whether the duty of good faith is a subset of loyalty rather than care or whether it is an overarching duty covering both concepts. The literature on both sides is vast and it is beyond the scope of this article to resolve this conceptual conundrum.

¹⁷ *Caremark*, 698 A.2d at 968.

¹⁸ *McCall v. Scott*, 239 F.3d 808 (6th Cir. 2001).

¹⁹ *Smith v. Van Gorkham*, 488 A.2d 858 (Del. 1985).

²⁰ *Aronson v. Lewis*, 475 A.2d 805, 812 (Del. 1984).

²¹ *Williams v. Geier*, 671 A. 2d 1368, 1376 (Del. 1996). See generally DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A RADIN, *THE BUSINESS JUDGMENT RULE* (5th ed. 1998); AMERICAN LAW INSTITUTE, *PRINCIPLES OF CORPORATE GOVERNANCE* § 401 (1994) [hereinafter ALI *PRINCIPLES*]. Even this is a default rule. In Delaware and certain other jurisdictions, corporations may adopt charter provisions and by-laws absolving directors of breaches of their duty of care, but may not protect intentional or criminal conduct. Del. Code Ann. Tit. 8, § 102(B)(7) (2010). See generally, MACEY, *supra* note 6, at 20.

²² *Unocal Corp. v. Mesa Petroleum Co.*, 493 A. 2d 946, 949 (Del 1985).

strongest when the decision of the board was approved by a majority of independent, disinterested directors.²³ Thus, plaintiffs have a heavy burden to both plead and prove that the board has breached its fiduciary duties of good faith, or due care.²⁴ Only then, will the court review the merits of the plaintiff's allegation to determine whether the conduct in question was fair to the corporation and its shareholders.²⁵ Even then, in the absence of faulty process, uninformed decision making, or a conflict of interest, the courts have been extremely reluctant to impose liability on corporations or its directors, no matter how disastrous the consequences of the board's decision turned out to be.²⁶

²³ Grabow v. Perot, 539 A.2d 180, 190 (Del. 1988).

²⁴ The application of the business judgment rule by courts is further complicated by the procedural rules which apply to shareholder derivative suits. A derivative lawsuit is a claim brought by shareholders on behalf of the corporation to redress harm done by the publicly traded company, its officers, or directors. Because such causes of action are deemed to belong to the corporation, the plaintiff normally must make a demand on the corporation (and its board of directors) for permission to sue on behalf of the corporation. The board of directors may accept or reject such demands and the recommendation of the board will be judged under the business judgment rule. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981). Not surprisingly most boards reject demand to initiate derivative actions.

However, demand may be excused when it is futile. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). This can include situations where the director's duty of loyalty is subject to challenge or where the board has acted outside the confines of the business judgment rule. Even in this situation, the board of directors can convene a special litigation committee to investigate the merits of the plaintiff's claim, report to the board, and recommend whether the case should be dismissed or continued. *Zapata*, 430 A.2d at 788-89. Most special litigation committees recommend the dismissal of the lawsuit they have investigated. The special litigation committee's recommendations are tested by the court first to determine whether the special litigation committee utilized a fair process in its determination. Only then would the court proceed to the "merits" of the case challenging the alleged violation of the board's duties and the harm to shareholders. *See generally*, FANTO, DIRECTORS & OFFICERS, *supra* note 16 at § 5.7; MACEY, *supra* note 6 at 130-40; BLOCK, *supra* note 21, at 1379-1808. For a more positive view of special litigation committees *see* Minor Meyers, *The Decisions of Corporate Special Litigation Committees: An Empirical Investigation*, 84 IND. L. REV. 1309 (2009).

²⁵ *See e.g.*, *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del 2006); *Cf.*, Jennifer Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WILL. & MARY L. REV. 1749 (2010) (study of federal court shareholder derivative actions showing few damage awards, but frequent changes in governance practices).

²⁶ *See e.g.*, *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. 1996).

The business judgment rule applies to allegedly poor action, rather than inaction, or an outright failure in board oversight. The board will be legally responsible for its failure to act when it has failed to consider a particular decision or exercise its judgment at all.²⁷ Taken as a whole, the board of directors (and particularly the outside directors) act as agents for the shareholders, but enjoy substantial protection from legal liability for their decisions (or lack thereof) when their actions (or inactions) were the result of a proper process, good faith, informed decision making, and without an outright conflict of interest.²⁸ This modern template has arisen out of the concerns first raised by Berle and Means, even if the modern expression of these concerns is different from what the founders of corporate governance themselves advocated for the modern corporation.

II. Antitrust and the Market

In contrast to corporate governance law which concerns itself with the internal organization of the public corporation, antitrust law is the law of competition between firms in the marketplace (no matter what the internal structure). The federal Sherman Act and later statutes prohibit three main forms of anticompetitive behavior without regard to whether the market actors are publicly traded corporations, privately owned corporations, partnerships and related entities, sole proprietorships, or actual individuals.

Section 1 of the Sherman Act prohibits “contracts, combinations and conspiracy” in “restraint of trade.”²⁹ As early as 1911, the Supreme Court held that only those agreements which “unreasonably” restrict competition are unlawful under Section 1 of the Sherman Act.³⁰ However, certain agreements are so inevitably destructive of competition that they are per se unreasonable, and hence

²⁷ In addition to the balance of fiduciary duties and the protections of the business judgment rule imposed by Delaware and other states corporate law, Congress has entered the picture in recent years with the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f)(1) and the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737, which require heightened pleadings standards for securities fraud allegation, automatic removal to federal court, and preemption of more generous state court rules.

²⁸ FANTO, DIRECTORS AND OFFICERS, *supra* note 16, at § 2.2.3(A)(3)(c).

²⁹ 15 U.S.C. § 1 (2010).

³⁰ Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).

unlawful.³¹ Examples of such per se unreasonable agreements between competitors include price fixing, market division, and output restrictions which are normally prosecuted as criminal offenses by the Antitrust Division of the Justice Department.³² All other agreements require more detailed and complete examination under a full rule of reason analysis to determine whether on balance they unreasonably restrict competition.³³ In this analysis, only the net effect on competition is legally relevant and not whether the agreement injures competition, but promotes some other socially useful value.³⁴

Anticompetitive behavior by single firms is covered by Section 2 of the Sherman Act which prohibits “monopolization” and “attempts to monopolize.”³⁵ In order to unlawfully monopolize, a firm must have monopoly power and engage in unlawful or exclusionary conduct to either acquire or maintain that monopoly.³⁶ In order to unlawfully attempt to monopolize, a firm must 1) have specific intent; 2) engage in unlawful or exclusionary conduct; and 3) and have at least a dangerous probability of achieving monopoly power.³⁷

The difficult issue for Section 2 analysis is identifying the difference between unlawful and exclusionary conduct on the one hand and hard competition or competition on the merits on the other hand. While the courts have struggled with this issue, there appears to be an evolving consensus that the proper approach is something akin to the rule of reason used in Section 1 analysis. In a number of recent Section 2 cases, the courts have sought to determine whether there is a significant adverse effect on competition and whether that effect is

³¹ United States v. Socony-Vacuum, 310 U.S. 150, 229 n.59 (1940).

³² See e.g., *Socony Vacuum*, 310 U.S. at 150; Scott D. Hammond, Deputy Ass’t U.S. Att’y. Gen., Antitrust Div., *The Evolution of Criminal Antitrust Enforcement Over the Last Two Decades*, Address before the National Institute on White Collar Crime (Feb. 25, 2010), available at <http://www.justice.gov/atr/public/speeches/255515.htm>.

³³ *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979); *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85 (1984); *Texaco v. Dagher*, 547 U.S. 1 (2006).

³⁴ *Nat’l Soc. of Prof’l Eng’rs v. United States*, 435 U.S. 679 (1978); *F.T.C. v. Trial Lawyers Ass’n*, 493 U.S. 411 (1990); see generally, Spencer Weber Waller, *Justice Stevens and the Rule of Reason*, 62 S.M.U. L. Rev. 693 (2009).

³⁵ 15 U.S.C. § 2. In addition Section 2 also prevents conspiracies to monopolize, a little used provision which is applied in a manner very similar to Section 1 of the Sherman Act.

³⁶ *United States v. Grinnell Corp.*, 384 U.S. 563 (1966).

³⁷ *Spectrum Sports v. McQuillan*, 506 U.S. 447 (1993).

outweighed by efficiency considerations, business justifications, or other pro-competitive justifications for the conduct at issue.³⁸

Finally, Section 7 of the Clayton Act prohibits mergers and acquisitions of all types if they tend to significantly lessen competition or tend to create a monopoly.³⁹ Here, the focus is on prediction and incipency and blocking acquisitions, regardless of form, if they would create a significant risk of harm to competition in the future. Government guidelines focus on the risks that the transactions will facilitate either outright collusion among the remaining players in the markets or anticompetitive oligopolistic (but nominally independent) price coordination.⁴⁰ In addition, the guidelines are equally concerned if a transaction would allow the merged entity to unilaterally raise price or restrict output.⁴¹ Most significant acquisitions are notified to the federal antitrust agencies in advance, although the transactions can also be challenged after closing.⁴² Joint ventures, strategic alliances, and other types of partial mergers can be analyzed under Section 7, although they may also be reviewed under Section 1 of the Sherman Act.⁴³

The antitrust laws only rarely are concerned with the internal structure of the firms whose conduct is under review. For example, the form of a merger and acquisition is only relevant to the extent that it provides evidence of the likely competitive effect of the transaction. However, a handful of situations exist where the form or structure of a corporate actor is necessary for antitrust purposes. As discussed below in part IV-A, Section 8 of the Clayton Act prohibits interlocking directorates under certain circumstances where it is necessary to understand both the competitive relationship of the firms in questions and the structure of their board of directors to determine whether this provision has been violated.⁴⁴

³⁸ *United States v. Microsoft Corp.*, 56 F.3d 1448 (D.C. Cir. 1995).

³⁹ 15 U.S.C. § 18.

⁴⁰ U.S. Dep't of Justice & Federal Trade Commission, Horizontal Merger Guidelines § 7 (Aug. 19, 2010), *available at* <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>. [hereinafter 2010 Horizontal Merger Guidelines].

⁴¹ 2010 Horizontal Merger Guidelines, *supra* note 40, at § 6.

⁴² 15 U.S.C. § 18a.

⁴³ *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964).

⁴⁴ *See* notes 129-40 and accompanying text.

In addition, sometimes corporate structure and organization is relevant to understanding whether the antitrust laws even apply. For example, Section 1 of Sherman Act requires the presence of a “contract, combination or conspiracy” before competitive effects come into question.⁴⁵ This requires some sort of an agreement for Section 1 to come into play, with Section 2 of the Sherman Act being the only antitrust provisions applying to truly unilateral conduct. The Supreme Court has determined that an agreement for Section 1 purposes means an agreement between two or more economically independent actors.⁴⁶ Thus, the Supreme Court has held that a corporation cannot conspire with its own employees, directors, officers, unincorporated divisions, and wholly owned subsidiaries.⁴⁷ The lower courts have extended this analysis and held in most circumstances that a corporation also cannot conspire with majority owned subsidiaries, or between sister subsidiaries owned by the same parent, where there is effective working control by the parent corporation.⁴⁸

III. Ships Passing in the Night

At the broadest level, corporate governance historically has focused on behavior and structure within the firm and antitrust has focused on behavior and structure between firms in the market. One is almost sub-atomic in nature and the other focusing on the interaction between business atoms and molecules. Unlike scientific inquiry however, the two fields have proceeded without any deep interaction and with little attempt to even understand each other’s domain.⁴⁹

There are both historical and professional reasons for these separate spheres of expertise and legal practice. Corporate law was

⁴⁵ 15 U.S.C. § 1; *see generally* ABA SECTION OF ANTITRUST LAW, PROOF OF CONSPIRACY UNDER FEDERAL ANTITRUST LAWS (2010).

⁴⁶ *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

⁴⁷ *Id.* at 777.

⁴⁸ *See* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 27-34 (6th ed. 2007)(collecting cases); *but see* *Am. Needle, Inc. v. Nat’l Football League*, ___ U.S. ___, 130 S.Ct. 2201, *available at* <http://www.supremecourt.gov/opinions/09pdf/08-661.pdf> (May 24, 2010)(rejecting claim that NFL should be treated as single economic entity in antitrust suit challenging exclusive licensing of team merchandise).

⁴⁹ One of the few scholarly pieces to connect the two fields focused on the boundaries between firms and markets as the key to its analysis. Edward B. Rock, *Corporate Law Through An Antitrust Lens*, 92 COLUM. L. REV. 497 (1992).

created first and until the Great Depression was almost entirely a creature of state law.⁵⁰ In contrast, antitrust began at the state level, but rapidly became almost exclusively national as state antitrust law was proven ineffective in controlling national corporations.⁵¹ There was a partial early convergence as strict anti-cartel rules, but loose merger rules, in the late nineteenth century were partially responsible for the initial wave of mergers that created and strengthened the large national corporations of the gilded age.⁵² But then paths diverged.

When the Sherman Act was passed in 1890, there was no specialized antitrust discipline or a specialized antitrust branch of the practicing bar or legal academy.⁵³ Antitrust law as a discipline did not appear until the 1920s and early 1930s.⁵⁴ By then, the Sherman Act had been supplemented by additional antitrust statutes and the courts had decided dozens of antitrust cases. The Federal Trade Commission ("FTC") had been created in 1914⁵⁵ and the Antitrust Division of the United States Department of Justice ("DOJ") in 1933.⁵⁶ Until the 1920s, antitrust was not even taught as a separate subject in American law schools. To the extent it was taught at all, it represented a small piece of such courses as Contracts, Corporations, or Business Planning.⁵⁷

Law firms were similarly slow in recognizing antitrust as a separate discipline. Few, if any, major law firms had separate antitrust departments until the early 1950s. The American Bar Association

⁵⁰ HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-1937 at 11-64 (1991).

⁵¹ James May, *The Role of The States in the First Century of Sherman Act and the Larger Picture of Antitrust History*, 59 ANTITRUST L.J. 93 (1990); James May, *Antitrust in the Formative Era: Political and Economic Theory in Constitutional and Antitrust Analysis, 1880-1918*, 50 OHIO ST. L.J. 257 (1989); James May, *Antitrust Practice and Procedure in the Formative Era: The Constitutional and Conceptual Reach of State Antitrust Law, 1880-1981*, 135 U. PA. L. REV. 495 (1987).

⁵² TONY FREYER, REGULATING BIG BUSINESS: ANTITRUST IN GREAT BRITAIN AND AMERICA, 1880-1990 AT 5-7, 15-16 (2008); BRIAN R. CHEFFINS, *MERGERS AND CORPORATE OWNERSHIP STRUCTURE: THE UNITED STATES AND GERMANY AT THE TURN OF THE 20TH CENTURY*, 51 AM. J. COMP. L. 473 (2003).

⁵³ See generally Spencer Weber Waller, *The Language of Law and the Language of Business*, 52 CASE W. RES. L. REV. 283 (2001).

⁵⁴ *Id.* at 285.

⁵⁵ *Id.* at 286.

⁵⁶ *Id.* at 286.

⁵⁷ *Id.* at 285.

("ABA") did not even have a separate Antitrust Section until 1952.⁵⁸ In contrast, corporate law was a well established specialty within the bar more than a half century earlier.⁵⁹ While corporate governance law was more of a creature of the 1930s it was quickly absorbed into this existing professional structure of the corporate bar and remained separate from the professional structure and discourse of antitrust.

As a result of the impact of the Berle and Means treatise and other developments in the wake of the stock market crash and the great depression, corporate governance law became part of the New Deal agenda and began to make its way into the legal structure of both state and federal law in the 1930s and beyond. At the federal level, the Securities and Exchange Commission was created to regulate the offerings of securities to the public and then later the operation of securities brokers and dealers.⁶⁰ However, the majority of corporate governance law was the province of state law, and Delaware in particular, and consisted of more explicit duties of loyalty and care to better align the interests of board members, corporate officers, and shareholders.⁶¹

Antitrust was not a significant part of either the analysis nor prescription in Berle and Means or the resulting corporate governance legal regime. This is not particularly surprising. Although Berle was knowledgeable and interested in antitrust issues,⁶² antitrust was at its absolute nadir at the time he was writing his masterpiece on corporate governance. When *The Modern Corporation and Private Property*

⁵⁸ Waller, *Language*, *supra* note 53, at 286.

⁵⁹ JEROLD S. AUERBACH, UNEQUAL JUSTICE: LAWYERS AND SOCIAL CHANGE IN MODERN AMERICA 23 (1977); William H. Simon, *Introduction: The Post-Enron Identity Crisis of the Business Lawyer*, 74 FORDHAM L. REV. 947, 950 (2005-2006); Jess M. Krannic, *The Corporate "Person": A New Analytical Approach to a Flawed Method of Constitutional Interpretation*, 37 LOY. U. CHI. L.J. 61, 72 (2005); S. Samuel Arsht, *A History of Delaware Corporate Law*, 1 DEL. J. CORP. L. 1 (1976).

⁶⁰ THOMAS LEE HAZEN, THE FEDERAL SECURITIES LAWS 1 (2d ed. 2003).

⁶¹ See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984); see generally MACEY, *supra* note 6, at 131. See e.g. *Bus. Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (invalidating SEC rule relating to voting rights by class of securities as beyond powers conferred by federal law).

⁶² See e.g., ADOLPH A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 43-51 (1954)(drawing links between antitrust and securities policies which promoted rise of institutional investor); NAVIGATING THE RAPIDS 1918-1971: FROM THE PAPERS OF ADOLPH A. BERLE 100-01, 158 (Beatrice Bishop Berle & Travis Beal Jacobs eds. 1973)(discussing different aspects of New Deal antitrust policy).

was published in 1933 during the depths of the Great Depression, the New Deal was following a collectivist path and antitrust had been almost entirely preempted or actually co-opted in the service of the de facto cartelization of the US economy under the National Recovery Act (NRA).⁶³ What little antitrust enforcement that existed was undercut by lax Supreme Court interpretation of the core anti-cartel provisions of Section 1 of the Sherman Act, also seemingly in deference to the special needs and circumstances of the Great Depression.⁶⁴ Antitrust law thus was effectively moribund until the NRA was held unconstitutional in 1935.⁶⁵

It was only then that President Roosevelt, out of principle, pragmatism, or perhaps desperation, chose to revive antitrust law and free market competition as a tool to solve the lingering depression. Robert Jackson, as head of the Antitrust Division of the Justice Department, began the cautious revival of antitrust enforcement.⁶⁶ This revival then kicked into high gear during the five year tenure of Thurman Arnold as head of the Antitrust Division from 1938-43.⁶⁷

Under Jackson, Arnold, and beyond, the Justice Department brought hundreds of criminal and civil cases in cartel and monopolization cases. This activism expanded into the merger area as well once Congress strengthened Section 7 of the Clayton Act into its modern form in 1950.⁶⁸ As a result of these government cases and numerous additional private cases, antitrust law shifted toward more and more per se rules,⁶⁹ presumptions against monopolization,⁷⁰ and

⁶³ ELLIS W. HAWLEY, *THE NEW DEAL AND THE PROBLEM OF MONOPOLY: A STUDY IN ECONOMIC AMBIVALENCE* (1966); ALLEN BRINKLEY, *THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR* (1996).

⁶⁴ *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933).

⁶⁵ *ALA Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935).

⁶⁶ ROBERT H. JACKSON, JOHN Q. BARRETT, & WILLIAM E. LEUCHTENBURG, *THAT MAN: AN INSIDER'S PORTRAIT OF FRANKLIN D. ROOSEVELT* (2004).

⁶⁷ See generally SPENCER WEBER WALLER, *THURMAN ARNOLD: A BIOGRAPHY* (2005).

⁶⁸ Pub L. No. 96-899, 64 Stat. 1225 (codified at 15 U.S.C. § 18).

⁶⁹ *United States v. Socony-Vacuum*, 310 U.S. 150 (1940); *Standard Oil Co. v. United States*, 337 U.S. 293 (1949); *United States v. Northern Pac. Ry.*, 356 U.S. 1 (1958); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).

⁷⁰ *United States v. Griffith*, 334 U.S. 100 (1948); *United States v. Al. Co. of Am.*, 148 F.2d 416 (2d Cir. 1945); see generally, Spencer Weber Waller, *The Story of Alcoa: The Enduring Questions of Market Power, Conduct, and Remedy in Monopolization Cases*, in *ANTITRUST STORIES* 121 (Eleanor M. Fox & Daniel A. Crane eds. 2007).

nearly absolute prohibition of significant mergers of any kind.⁷¹ Such limitations proved far more significant than the more modest corporate governance constraints of that era.

One snapshot of this era can be found in *The Corporation and Modern Society*, a collection of essays edited by the economist Edward Mason in 1960 written by prominent legal and economic scholars.⁷² This collection reflects its times where antitrust rules were strong and corporate governance constraints weak.⁷³ The primary concerns expressed are the oligopoly status of key U.S. corporations and the economic, political, and social power of corporations more generally.⁷⁴ Pure corporate governance concerns or agency costs were at most a secondary theme of the book and a direct concern of perhaps two of the chapters in the volume.⁷⁵

Enter the market for corporate control. Henry Manne argued in his seminal article in 1965 that overly stringent antitrust rules against mergers did little to protect competition and primarily served to entrench inefficient management to the detriment of shareholders, consumers, and competition more generally.⁷⁶ Manne directly cited Berle and Means and their concern for the detrimental effects of the separation of ownership and management as one of the key bases for his proposals and stated: "[t]he market for corporate control gives to these shareholders both power and protection commensurate with their interests in corporate affairs."⁷⁷ Later influential writings by Frank Easterbrook, Daniel Fischel, and others echoed these themes and

⁷¹ *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. Phila. Nat'l Bank*, 374 U.S. 321 (1963); *Alcoa*, 377 U.S. at 271; *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *United States v. E. I. duPont*, 353 U.S. 586 (1986); *Ford Motor Co. v. United States*, 405 U.S. 562 (1972); *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

⁷² *THE CORPORATION IN MODERN SOCIETY* (Edward Mason ed. 1960).

⁷³ See Mark J. Roe, *From Antitrust to Corporation Governance? The Corporation and the Law: 1959-1994*, in *THE AMERICAN CORPORATION TODAY* at 102 (Carl Kaysen ed. 1996).

⁷⁴ Carl Kaysen, *The Corporation: How Much Power? What Scope?*, in MASON, *CORPORATION IN MODERN SOCIETY*, *supra* note 72, at 85, 89-90.

⁷⁵ See Abram Chayes, *The Modern Corporation and the Rule of Law*, in MASON, *supra* note 72, at 25; Eugene V. Rostow, *To Whom and for What Ends is Corporate Management Responsible?*, in MASON, *supra* note 72, at 46.

⁷⁶ Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

⁷⁷ *Id.* at 112.

advocated a robust takeover market as a way to constrain managerial inefficiency, prevent rent seeking, and increase shareholder value.⁷⁸

The calling for a well developed market for corporate control required important changes in both antitrust and corporate governance. At the time of Henry Manne's original article, there were strong presumptions that any merger that increased market concentration to any appreciable degree was unlawful.⁷⁹ It got to the point where Justice Potter Stewart noted in frustration that the only apparent consistency in antitrust challenges to mergers was that "the government always wins."⁸⁰

This rapidly changed for antitrust in general and mergers in particular. Most per se rules outside of the cartel area were abandoned in favor of a broader more economically intensive inquiry under the rule of reason.⁸¹ The plaintiff, rather than the defendant had the burden of proof that a defendant had meaningful monopoly power (or nearly so) and that it had acted to harm competition without an offsetting business justification.⁸²

In the merger area, the change was even more dramatic. The presumption of illegality where industry concentration increased was weakened.⁸³ Government guidelines laid out a much higher degree of market concentration and a more rigorous analytical framework before the government would seek to challenge most mergers.⁸⁴ The courts, in turn, began to hold the government to these higher burdens of proof, although the guidelines on their face only spoke to questions of

⁷⁸ MACEY, *supra* note 6, at 118-26; Frank Easterbrook & Daniel Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982).

⁷⁹ *United States v. Phila. Nat'l Bank*, 374 U.S. 321 (1963).

⁸⁰ *United States v. Von's Grocery*, 384 U.S. 270, 301 (1966)(Stewart, J. dissenting).

⁸¹ *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979); *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85 (1984); *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977); *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985); *Texaco v. Dagher*, 547 U.S. 1 (2006); *State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

⁸² *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

⁸³ *United States v. Gen. Dynamics Corp.*, 415 U.S. 486 (1974).

⁸⁴ 2010 Horizontal Merger Guidelines, *supra* note 40, at § 0.1.

prosecutorial discretion and not directly to case law and litigation.⁸⁵ The rise of the market for corporate control thus coincided with a weakening of merger control and even calls within the Reagan Administration in the 1980s to abolish Section 7 of the Clayton Act entirely.⁸⁶

On the corporate governance side, important changes were happening as well. Increased duties to maximize the value of the corporation emerged once a meaningful bidding process has begun.⁸⁷ On the other hand, the courts were much less willing to limit corporations from enacting poison pills and similar anti-takeover devices which protected management.⁸⁸ Finally, a number of states enacted anti-takeover statutes which generally survived court challenge.⁸⁹

In more recent times, the corporate scandals of the late 1990s, the new millennium, and the ongoing financial crisis have led to other important changes in corporate governance, often reactive to the crisis or scandal of the moment. The accounting and fraud scandals of the Enron era led to the Sarbanes-Oxley Act and greater duties of CEOs and CFOs in connection with the preparation and certification of financial statements.⁹⁰ The 2008 financial crisis that began with the melt-down of the US sub-prime mortgage market and then spread throughout the US and global economy led to a series of financial reform measures enacted in the summer of 2010 all of which contain regulatory, disclosure, and corporate governance proposals of different natures.⁹¹ Thus, in some areas of corporate governance the federal

⁸⁵ *United States v. Waste Mgmt., Inc.*, 743 F.2d 976 (2d Cir. 1984); *United States v. Baker Hughes*, 908 F.2d 981 (D.C. Cir. 1990); *FTC v. Oracle*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004); *FTC v. Arch Coal*, 329 F. Supp. 2d 109 (D. D.C. 2004).

⁸⁶ See *ABA Antitrust Section Examines Deregulation, Enforcement Shifts*, 49 ANTITRUST & TRADE REG. REP. (BNA) 156 (1985); *Monopolies Subcommittee Receives Views on Division's Enforcement Record*, 48 ANTITRUST & TRADE REG. REP. (BNA) 455 (1985).

⁸⁷ *Paramount Commc'ns, Inc. v. QVC*, 637 A.2d 34 (Del. 1994); *Revlon v. MacAndrews*, 506 A.2d 173 (Del. 1985).

⁸⁸ *Paramount Commc'ns, Inc. v. Time, Inc.* 571 A.2d 1140, 1155 (Del.1989); *Moran v. Household*, 500 A.2d 1346 (Del. 1985)(no violation of fiduciary duties in maintaining or approving poison pill).

⁸⁹ *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987).

⁹⁰ Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (enacted July 30 2002).

⁹¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L. No. 111-203, 124 Stat. 1376 (Slip Copy, July 21, 2010).

securities and regulatory provisions may have far greater impact on corporate boards and committees than the more forgiving Delaware corporate law.⁹²

At the same time, antitrust law and enforcement appear to be on a mild resurgence. Most commentators consider the Bush era Antitrust Division to be relatively inactive on antitrust enforcement, on any issue other than criminal cartel enforcement, and also typically hostile to private antitrust suits.⁹³ In contrast, the Obama administration almost immediately announced plans for more aggressive enforcement of the antitrust laws beyond the cartel area,⁹⁴ and has pursued a modestly expanded array of investigations, cases, settlements, and amicus briefs in its first and a half year in office.

What emerges is a pattern of oscillation. At most times over the past 120 years, the relative strength of antitrust and corporate law has been like two sine waves which only occasionally intersected as one field was on the rise and the other was been on the decline. We are at a rare historical intersection point where both fields are in positions of relative strength and only time will tell if that is a stable trend or merely another brief intersection as one field is strengthened through legislation and court interpretation and the other weakened by

⁹² FANTO, *supra* note 16, at § 3.32.

⁹³ There is a more complex picture at the FTC during this period which continued to bring a number of high profile civil non-merger cases. See William E. Kovacic, Burnell Lecture on U.S. Federal Trade Commission, *The Future of U.S. Competition Policy at Home and Abroad* (23 Mar., 2009), available at <http://www.ftc.gov/speeches/kovacic/090323burnelllecture.pdf>. One example of the difference in enforcement philosophies between the two agencies during this era was the Schering-Plough case where the FTC lost an attempted monopolization case at the appellate level and unsuccessfully sought certiorari in the Supreme Court alone and against the express opposition of the Justice Department. *FTC v. Schering-Plough*, 402 F. 3d 1056 (11th Cir. 2005), *cert. denied*, 548 U.S. 919 (2006). Another example was the refusal of the FTC to sign onto the now withdrawn report issued by the Antitrust Division proposing overly narrow standards for the imposition of liability for unilateral conduct under Section 2 of the Sherman Act. U.S. Dep't of Justice, Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act (2008), available at <http://www.justice.gov/atr/public/reports/236681.pdf>.

⁹⁴ Christine A. Varney, Assistant Attorney General Antitrust Division, U.S. Department of Justice, *Vigorous Antitrust Enforcement in this Challenging Era*, Remarks as Prepared for the Center for American Progress (May 11, 2009), available at <http://www.justice.gov/atr/public/speeches/245711.htm>; see also Spencer Weber Waller & Jennifer Woods, *Antitrust Transitions*, 32 WORLD COMP. L. & ECON. REV. 189 (2009).

the same developments. This continuing oscillation is another explanation for the very rare interaction for two fields both intimately concerned about corporate actors and their interaction in the marketplace.

The current equilibrium, if it holds, is an equally rare opportunity to do better.⁹⁵ When antitrust and corporate governance were out of synch it was widely believed that these two bodies of law were substitutes.⁹⁶ Today, the better view is that they are complements and should operate in a coordinated and consistent manner to promote the interests of both consumers and shareholders.⁹⁷

IV. Towards A More Meaningful Interaction

This section looks at several of the more obvious and important areas where an understanding of agency costs can inform the broader market competition questions that antitrust law addresses, and vice-versa. Woven throughout the discussion is the critical area of corporate compliance law where the internal structure and operation of corporate entities can affect their ability to comply with antitrust (and other legal and regulatory schemes) and detect violations when they occur.

⁹⁵ There will always be areas of corporate governance like executive compensation, board selection and retention, shareholder voting, and accounting rules and audit procedures that only rarely implicate competition policy. Although beyond the scope of this article, Professor Macey has identified the “cartelization” of stock exchanges, accounting firms, and credit rating agencies as an additional source of poor corporate governance. MACEY, *supra* note 6, at 105-17. By “cartelization”, Professor Macey appears to mean increased concentration and the creation of regulatory barriers to entry, rather than a literal private conspiracy in restraint of trade in violation of Section 1 of the Sherman Act.

Congress has recognized at least one piece of this competition-corporate governance puzzle with the passage of the Credit Rating Duopoly Relief Act, H.R. 2990, 109th Cong. (2009). The effect of this statute is still uncertain, but the dismal performance of the credit rating industry in the financial crisis of 2008 suggests that neither competition nor corporate governance has improved in this sector. John P. Hunt, *Credit Rating Agencies and the ‘Worldwide Credit Crisis’: The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 1, 9-13 (2009).

⁹⁶ Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

⁹⁷ D. Danny Sokol, *Competition Policy and Comparative Corporate Governance of State-Owned Enterprises*, 2009 BYU L. Rev. 1713.

Part A introduces the general standards for corporate compliance. Part B examines interlocking directorates, the only current area where Congress has directly addressed the antitrust-corporate governance intersection by statute. Part C looks at cartel policy, where better governance principles and compliance policies can deter and prevent the type of hard-core antitrust violations that constitute criminal violations for the corporation and its officers, directors, and employees. Part D looks beyond past cartel issues into the murkier areas of the anticompetitive agreements which are not illegal per se, but are judged on a case-by-case basis under the Rule of Reason. Part E looks at merger policy, an area where greater attention to corporate governance concerns illustrates certain weaknesses in current antitrust thinking. Finally Part F analyzes the area of monopolization and attempted monopolization where the uncertainties of what constitutes market power and its unlawful exercise are sufficiently vague and nuanced that the current regime of the business judgment rule normally seems appropriate.

A. Corporate Compliance

Although most courts historically rejected imposing a requirement that boards institute compliance programs because directors “are entitled to rely on the honesty and integrity of their subordinates until something occurs to put them on suspicion that something is wrong,”⁹⁸ recent decisions signify a shift in such ideology. First, *Allis-Chalmers* established a duty to act when directors become aware of “red flags,” e.g., illegal or wrongful activities.⁹⁹ This decision was Delaware’s first addressing to what extent directors must ensure legal compliance of the companies officers and employees.¹⁰⁰

A derivative suit alleged that the directors of Allis-Chalmers were liable for their employee’s violations by reason of their failure to take action to uncover and prevent antitrust violations on the part of any employees of Allis-Chalmers.¹⁰¹ The facts demonstrated that the directors had no actual knowledge of any antitrust violations or even

⁹⁸ *Graham v. Allis-Chalmers*, 188 A.2d 125 (Del. 1963) (citing *Briggs v. Spaulding*, 141 U.S. 132 (1891)).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 127.

reason to know of any potential wrongdoing until officials announced an investigation of the company.¹⁰² Nevertheless, the plaintiffs argued, in the alternative, that, by virtue of their fiduciary duties, directors were bound to put a compliance system into effect, which would bring misconduct to their attention.¹⁰³

The Delaware Supreme Court disagreed. The court reasoned that precedent rejected such a burden, and noted that directors may rely on the honesty and integrity of corporate employees in the absence of red flags.¹⁰⁴ Thus, the Allis-Chalmers directors were not liable for the actions of their subordinates.

Allis-Chalmers broke significant ground by recognizing that a director's fiduciary duties could include the duty to monitor, however, it provided little incentive for directors to actually "monitor." Notably, the court, in creative language, refused to impose a duty "to install and operate a corporate system of espionage to ferret out wrongdoing."¹⁰⁵ In other words, there was no duty to institute corporate compliance systems. In 1996 this changed.

In a groundbreaking shift in corporate governance, the Delaware Court of Chancery in the *Caremark* litigation expanded a director's duty to act not only when exposed to obvious signs of wrongdoing, but to be informed and be vigilant to uncover wrongdoing.¹⁰⁶ The decision stemmed from a federal investigation of "kickback" payments to physicians in exchange for patient referrals. Caremark eventually entered into a \$250 million settlement. At which time, Chancellor Allen, the author of the decision, saw an opportunity to require directors to oversee legal issues.¹⁰⁷

In approving the settlement, Chancellor Allen demonstrated that directors could no longer assume that the corporation was in compliance with the law. Rather, they have a "duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director

¹⁰² *Id.* at 128-29.

¹⁰³ *Id.* at 130.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959 (1996).

¹⁰⁷ Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: Directors' Evolving Duty to Monitor*, in *CORPORATE LAW STORIES* 323-346 (J. Mark Ramseyer, ed. 2009).

liable for losses caused by non-compliance.”¹⁰⁸ Chancellor Allen treated this duty as an extension of directors’ duty to act in good faith, preventing courts from second guessing directors’ business decisions.¹⁰⁹

To show bad faith, plaintiffs must demonstrate that the board failed in a “sustained or systematic”¹¹⁰ fashion. This includes an “utter failure” by the board to develop a reasonable information-reporting system.¹¹¹ An actual failure to prevent wrongdoing does not, by itself, indicate that a board failed in its duty to monitor.¹¹² Even a grossly unreasonable failure to act does not meet the bad-faith threshold.¹¹³

In *Stone*, the Delaware Supreme Court reinforced, but narrowed, the *Caremark* decision, placing directors’ duty to monitor in line with the duty of good faith, a subset of the duty of loyalty.¹¹⁴ As a result, directors breach their duty to monitor when they either “utterly fail[] to implement any reporting or information system or controls” or if they “consciously fail[] to monitor or oversee operations thus disabling themselves from being informed of risks or problems requiring their attention.”¹¹⁵

Stone stemmed from a derivative suit brought by AmSouth Bancorporation shareholders against the board for allowing employees to violate reporting requirements under the federal Bank Secrecy Act. Although the court affirmed *Caremark*’s good faith standard, it also identified a scienter requirement, stating that “imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.”¹¹⁶

These key cases and the numerous ones that have followed in their wake establish three key principles: (1) a plaintiff must show scienter—that the board acted with the actual or constructive knowledge that its inaction would harm the corporation, (2) the board is responsible for preventing wrongful or illegal acts, but (3) is not

¹⁰⁸ *In re Caremark*, 698 A.2d at 970.

¹⁰⁹ *Id.* at 967.

¹¹⁰ *Id.* at 971.

¹¹¹ *Id.*

¹¹² *Id.* at 972.

¹¹³ *Id.* at 970-71.

¹¹⁴ 911 A.2d 362 (Del. 2006). See generally *Symposium: Good Faith After Disney*, 55 N.Y.L. SCH. L. REV. 421-670 (2010-11).

¹¹⁵ 911 A.2d at 370.

¹¹⁶ *Id.*

responsible for monitoring outcomes of decisions of previous boards.¹¹⁷

Recent cases indicate a greater willingness to infer knowledge of wrongdoing. In *American International Group v. Greenberg*, the court inferred the defendants' knowledge from their high level management positions, because it was unlikely that illegal transactions would have occurred without their knowledge.¹¹⁸

The *duty of care* generally requires that directors act in good faith and with the degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances. At the same time, the business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."¹¹⁹ The rule effectively prevents the judiciary from reviewing, after the fact, the merits of most board's business decisions. Accordingly, a plaintiff challenging a corporate board's business decision(s) made on an informed and good faith basis bears the burden of rebutting the business judgment rule presumption.¹²⁰

The business judgment rule does not protect all corporate action, however. First, the rule does not apply if a plaintiff can show that directors acted with self-interest (self-dealing).¹²¹ Second, the rule does not apply where directors abdicate their responsibility or when they failed to act, as in duty to monitor cases.¹²² Third, the rule does not apply to decisions lacking a rational business purpose.¹²³ Courts make this determination from the vantage point of the directors at the time they made the decision, not with hindsight.¹²⁴ Fourth, the

¹¹⁷ Eric. J. Pan, *A Board's Duty to Monitor*, 54 N.Y.U. L. REV. 719 (2009).

¹¹⁸ 60 A.D.3d 483 (N.Y. App. Div. 2009). *But see* *In re Citigroup, Inc. Shareholders Deriv. Litig.*, 964 A.2d 106, 124-26 (Del. Ch. 2009)(adopting less expansive view of inferring knowledge of wrongdoing).

¹¹⁹ *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

¹²⁰ *Id.* at 805.

¹²¹ *Id.* at 812.

¹²² *Aronson*, 473 A. 2d at 813.

¹²³ *Brehm v. Eisner*, 746 A.2d 244, 264 n. 66 (Del. 2000)(summarizing the business judgment rule and relevance of a rationale business purpose in decisions by directors).

¹²⁴ AMERICAN LAW INSTITUTE, *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 4.01(c)(3) (2010)(comment c).

rule does not protect decisions involving gross negligence.¹²⁵ In the event that the business judgment rule does not apply, the board must prove the “entire fairness” of the transaction.¹²⁶

The business judgment rule rests largely on the presumption that directors (business professionals) – rather than courts – boast the business acumen required to sufficiently assess the economic risk associated with their often complex decisions.¹²⁷ The rule protects directors from liability for errors or mistakes in judgment, thereby ensuring corporate freedom to make their own rational and informed judgments without fear of backlash with the benefit of hindsight. Thus, the rule permits immunizing the substance of a decision derived from diligent and informed analysis.¹²⁸ “Process” is essential in determining whether the board acted with due diligence.

When applied to antitrust, this produces critical but unresolved issues. First, what is a sufficient monitoring system so that the board has, in good faith, required monitoring and compliance systems that reasonably can be expected to deter, detect, and prevent serious antitrust violations by the officers, employees, and directors of the corporation? Second, what are the red flags necessary for the board to take further action when unlawful conduct may have occurred? Finally, how do the duties of care, the requirement of adequate monitoring and compliance systems, and the business judgment rule interact when the board fails to take action and the corporation is subsequently found guilty or liable, or chooses to settle allegations of substantial antitrust wrong doing?

The case law and commentary provides surprisingly few clues.¹²⁹ The answer is likely to be different depending on which area of antitrust and which type of violation is at issue. The following sub-

¹²⁵ *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985); *see generally* Steven A. Ramirez, *The Chaos of Smith*, 45 WASH. L. REV. 343 (2006).

¹²⁶ *Cede & Co. v. Technicolor, Inc.*, 634 A2d 345 (Del. 1993).

¹²⁷ *See, e.g.*, L. Corp. Offs. & Dirs.: Rts., Duties & Liabs. § 2:10 (2009); Daniel Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 Bus. L. 1437, 1441 (1985).

¹²⁸ *Briggs v. Spaulding*, 141 US 132 (1891).

¹²⁹ In contrast, the issue has received much more comprehensive treatment in the United Kingdom where the UK competition enforcer, the Office of Fair Trading, has produced an excellent recent comprehensive study of corporate compliance in competition law; *see* Office of Fair Trading, *Drivers of Compliance and Non-compliance with Competition Law*, An OFT Report, May 2010, OFT 1227, available at <http://www.oft.gov.uk/OFTwork/publications/publication-categories/reports/competition-policy/oft1227>.

sections discuss the nature of red flags and board duties for the most common types of antitrust violations and suggest that the highest duties should be imposed with respect to cartel type violations, the least for monopolization type offenses, and an intermediate standard for mergers.

B. Interlocking Directorates

The only direct statutory interplay between corporate governance and competition policy can be found in Section 8 of the Clayton Act which states:

No person shall, at the same time, serve as a director or officer in any two corporations (other than banks, banking associations, and trust companies) that are -
(A) engaged in whole or in part in commerce; and
(B) by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws...¹³⁰

This provision is limited to corporations above a certain size and where competitive sales are above a certain threshold.¹³¹ Only interlocking directorates between horizontal competitors are covered by this provision, despite its wording suggesting that interlocking directorates between vertically related corporations would be subject

¹³⁰ 18 U.S.C. § 19 (2010).

¹³¹ These limits are indexed to inflation and currently Section 8 of the Clayton Act only applies if the corporations have capital, surplus and undivided profits above \$25,841,000 each and where competitive sales are above \$2,584,100 and at least 2 per cent of that corporation's total sales or the competitive sales of each corporation are at least 4 per cent of that corporation's total sales. COMMISSION ANNOUNCES REVISED FILING THRESHOLDS FOR CLAYTON ACT ANTITRUST REVIEWS; FOLLOWING REVIEW, COMMISSION DECIDES TO RETAIN THE AMPLIFIER RULE; FTC APPROVES FINAL CONSENT ORDERS IN CASES AGAINST SIX BUSINESSES THAT CLAIMED TO COMPLY WITH AN INTERNATIONAL PRIVACY FRAMEWORK; FTC APPROVES FINAL CONSENT ORDER IN MATTER CONCERNING WATSON PHARMACEUTICALS AND ARROW PHARMACEUTICALS, AVAILABLE AT [HTTP://WWW.FTC.GOV/OPA/2010/01/HSR-SAFEHARBOR.SHTM](http://www.ftc.gov/opa/2010/01/HSR-SAFEHARBOR.SHTM).

to this provision as well.¹³² Section 8 also does not reach interlocking directorates between bank and non-bank corporations.¹³³ Although there are occasionally boundary issues as to whether corporations should be deemed horizontal competitors,¹³⁴ or whether the statute reaches situations where the corporation own subsidiaries which compete, the statute is straightforward enough. It thus represents a *per se* ban on a limited number of types of horizontal interlocking directorates.¹³⁵ No proof of competitive effects is required.

As a result, individuals and corporations simply act accordingly in the real world. There is not that much litigation.¹³⁶ When disputes arise, the remedy is normally the resignation of a director from one of the two competing enterprises or occasionally the divestiture of a business line so the firms are no longer competing and no longer subject to these provisions. Sometimes, the firms act preemptively; sometimes the remedy is embodied in a consent decree depending on the stage of the investigation or litigation.

Most recently, Eric Schmidt, then the CEO of Google, resigned as a director of Apple to resolve questions whether his dual service on both company's boards violated this provision. Press reports indicate that the FTC is continuing to investigate whether other board level interlocks between these two actual and potential competitors raises similar issues.¹³⁷

¹³² *Paramount Pictures*, 93 F.T.C. 325, 379 (1979), *aff'd in part & rev'd in part*, 647 F. 2d 942 (9th Cir. 1981).

¹³³ *BankAmerica Corp. v. United States*, 462 U.S. 122 (1983); *see generally* ABA ANTITRUST SECTION, MONOGRAPH NO. 10, INTERLOCKING DIRECTORATES UNDER SECTION 8 OF THE CLAYTON ACT (1984); Arthur H. Travers, Jr., *Financial interlocks After the BankAmerica Case*, 53 ANTITRUST L.J. 1067 (1985); Amy Corton, *BankAmerica v. United States – Legitimizing Bank-NonBank Interlocks*, 33 EMORY L.J. 1103 (1984).

¹³⁴ *See* Benjamin M. Gerber, *Enabling Interlock Benefits While Preventing Anticompetitive Harm: Toward an Optimal Definition of Competitors Under Section 8 of the Clayton Act*, 24 YALE J. REG. 107 (2007).

¹³⁵ *See* William C. MacLeod, *Interlocks at the Federal Trade Commission: Room for Reason in a "Per Se" Statute?*, 53 ANTITRUST L.J. 1077 (1985); Note, *Clayton Act Prohibition of Interlocking Directorates in Industrial or Commercial Corporations*, 54 COLUM. L. REV. 130 (1954).

¹³⁶ Cases involving challenges to interlocking directorates under Section 8 of the Clayton Act are collected in I ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENT 426-31 (6th ed. 2007).

¹³⁷ *Despite Google's Schmidt resignation from Apple board, FTC investigation continues; Gore next to go?*, available at

Preventing conflicts of interest and creating proper incentives for directors underlie this entirely sensible, but limited provision. Interlocking directorates between competitors can pose both competition and corporate governance problems. They can exacerbate the agency cost problems when a director's decisions can benefit his own interests in his other role with the competitor rather than serve the best interests of the shareholders at the company where he serves as a director. At an extreme, they can be a direct violation of the duty of loyalty for either or both of the corporations where the director serves.

These concerns must also be balanced against the value of knowledgeable experienced directors who have the ability to play an important engaged role as outside directors to minimize the agency costs that is the avowed goal of corporate governance law in the first place.¹³⁸ If the statute operates as intended, obviously a certain number of highly qualified directors will be excluded and publicly traded companies will have to find outside directors from a somewhat different pool of candidates.

On the competition side of the fence, the dangers can be equally straightforward. Interlocking directorates could facilitate outright collusion,¹³⁹ but could also be a facilitating mechanism for the exchange of information or other means of oligopolistic coordination and tacit collusion. Interlocking directorates can also affect key board level decisions involving mergers, acquisitions, joint ventures, entry into new markets, innovation initiatives, and other key strategic determinations that can affect the competitive efforts of one or both of the affected firms.¹⁴⁰

The current statute, while not perfect, is nonetheless an appropriate compromise. It can be both over- and under-inclusive in particular settings. Section 8 also is not precise in the definition of competing firms which raises issues for companies with operations in multiple markets and for companies where the boundaries of even

http://www.macdailynews.com/index.php/weblog/comments/despise_googles_schmidt_resignation_from_apple_board_fic_investigation_cont/.

¹³⁸ Gerber, *supra* note 134, at 112-15.

¹³⁹ Christopher R. Leslie, Trust, Distrust, and Antitrust, 82 TEX. L. REV. 517, 583-84 (2004) (discussing historical use of interlocking directorates as trust facilitating device).

¹⁴⁰ Mehdi Farhadi, *How Major Public-Listed Blue Chip Enterprises in Germany Protect Themselves from Hostile Takeovers by Foreign Investors Through Networks of Interlocking Directorates*, available at <http://ssrn.com/abstract=1262660>.

specialized operations are evolving rapidly, as in the high-tech sector.¹⁴¹ However, further precision would probably come at such a high cost that the incremental gains would not be worthwhile for either competition policy or corporate governance. What emerges most is the value of first Congress, and then the courts and commentators, identifying an important, but limited, area where there is real utility from thoughtfully addressing previously these two separate legal spheres in a unified manner. If the prohibition of interlocking directorates is a qualified success, then the failure to integrate corporate governance and competition policy in more pressing areas of concern is a far more troubling example of failing to draw these same connections.

C. Cartels

Perhaps the most important area of corporate compliance relates to the deterrence, prevention, detection, and response to credible allegations of price fixing, bid rigging, and related cartel behavior. These are the hard-core cartel offenses that are per se unlawful and normally prosecuted as criminal violations by the Antitrust Division. The conspiracy itself is the offense and no proof of effect is required.¹⁴² Essentially these per se unlawful conspiracies are presumed unreasonable and no rebuttal evidence is permitted as to their intended or actual effect.¹⁴³ The Supreme Court has gone so far as to state in dicta that cartels are “public enemy number one” for antitrust purposes.¹⁴⁴

Whether or not this is literally true,¹⁴⁵ criminal conviction (and even investigation) holds heavy consequences for the corporations and individuals involved. Section 1 of the Sherman Act makes an antitrust crime a felony.¹⁴⁶ The criminal penalties for a corporation are fines up to the higher of \$100,000,000 or double the gain or loss involved in the offense.¹⁴⁷ Fines for cartel offenses have reached as high as

¹⁴¹ Gerber, *supra* note 134, at 118-20.

¹⁴² *Socony-Vacuum v. United States*, 310 U.S. 150, 224 n.59 (1940).

¹⁴³ 15 U.S.C. § 1.

¹⁴⁴ *Verizon Commc'ns v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004).

¹⁴⁵ Maurice Stucke, *Should the Government Prosecute Monopolies?*, 2009 U. ILL. L. REV. 497 (2009).

¹⁴⁶ 15 U.S.C. § 1.

¹⁴⁷ *Id.*

\$500,000,000 and there are dozens of fines in excess of \$100,000,000.¹⁴⁸

For individuals, the monetary penalties are smaller, but the stakes even higher. Individuals, unlike corporations, are subject to imprisonment and not just heavy fines. A violation of Section 1 can result in a prison term of up to ten years.¹⁴⁹ Virtually every conviction in modern times has resulted in a prison term for corporate employees, officers, and directors, ranging from relatively low level employees to Presidents and CEOs.¹⁵⁰ The longest prison term to date has been 46 months.¹⁵¹

The criminal prosecution is often just the beginning of the troubles for the firms involved. A conviction or guilty plea in a government criminal case is *prima facie* evidence of liability in any follow up civil treble damage litigation who would then need only to prove standing, causation, and damages in order to receive treble damages, attorneys fees, and costs.¹⁵² Many of these actions are filed in the form of a class action which further raises the stakes. Settlements by co-defendants are deducted pre-trebling.¹⁵³ In *Pari delicto* defenses are not allowed.¹⁵⁴ Liability is joint and several.¹⁵⁵ Contribution claims among defendants are not allowed,¹⁵⁶ although contractual judgment sharing agreements have been allowed.¹⁵⁷ Further, to the extent that an antitrust can be deemed an intentional crime or tort, antitrust judgments may not be insurable.¹⁵⁸

¹⁴⁸ Hammond, *supra* note 32, at 5-6.

¹⁴⁹ 15 U.S.C. § 1.

¹⁵⁰ THE INFORMANT! (Howard Braunstein et. al. 2009) (fictionalized account of actual international cartel agreement for food additives reaching into higher executive and board ranks of conspirators).

¹⁵¹ JAMES ATWOOD, KINGMAN BREWSTER & SPENCER WEBER WALLER, II ANTITRUST AND AMERICAN BUSINESS ABROAD § 15.3 (3d ed. 1997 & annual supp.).

¹⁵² 15 U.S.C. § 5.

¹⁵³ Zenith Radio Corp. v. Hazeltine Research, 401 U.S. 321, 348 (1969). *See generally* LAWRENCE A. SULLIVAN & WARREN G. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 17.8b (2d ed. 2006).

¹⁵⁴ Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 140 (1968).

¹⁵⁵ Burlington Industries v. Milliken & Co., 690 F.2d 380, 393 (4th Cir. 1982).

¹⁵⁶ Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981).

¹⁵⁷ Christopher R. Leslie, *Judgment Sharing Agreements*, 2009 DUKE L. J. 747.

¹⁵⁸ JEFFREY W. STEMPER, INTERPRETATION OF INSURANCE CONTRACTS, LAW AND STRATEGY FOR INSURERS AND POLICYHOLDERS Ch. 15 (1994). Some states would go further and bar insurability of antitrust treble damage verdicts as punitive damages. *Id.* at 7.3, & 15.3. *See generally* 17 WILLISTON ON CONTRACTS § 49:115 (4th ed. 2002) (discussing insurance coverage of intentional criminal acts).

One of the government's most effective anti-cartel tools is the amnesty and leniency program which has been widely copied abroad. Beginning in the early 1990s, the Department of Justice adopted a set of formal written guidelines setting forth when the government would grant immunity for cartel participants who informed the Antitrust Division of cartel activity and provided truthful cooperation going forward.¹⁵⁹ Under the amnesty and leniency program, corporations and individuals receive immunity from criminal prosecution if:

- At the time the corporation comes forward to report the illegal activity, the Division has not received information about the illegal activity being reported from any other source;
- The corporation, upon its discovery of the illegal activity being reported, took prompt and effective action to terminate its part in the activity;
- The corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division throughout the investigation;
- The confession of wrongdoing is truly a corporate act, as opposed to isolated confessions of individual executives or officials;
- Where possible, the corporation makes restitution to injured parties; and
- The corporation did not coerce another party to participate in the illegal activity and clearly was not the leader in, or originator of the activity.¹⁶⁰

If a corporation qualifies for leniency, directors, officers, and employees of the corporation also will not be charged criminally if they admit their wrongdoing with “candor and completeness” and continue to assist the Division throughout the investigation.¹⁶¹

¹⁵⁹ U.S. Dep't of Justice, Corporate Leniency Policy (1993), *available at* <http://www.justice.gov/atr/public/guidelines/0091.htm>; U.S. Dep't of Justice, Individual Leniency Policy (1994), *available at* <http://www.justice.gov/atr/public/guidelines/0092.htm>.

¹⁶⁰ Corporate Leniency Policy, *supra* note 159, at Section A. Alternative discretionary conditions for granting immunity are set forth in Section B of the policy.

¹⁶¹ *Id.* at Section C.

Immunity from criminal prosecution will not shield the corporation from private damage suits. In fact, it normally makes settlement of subsequent private litigation for cartel overcharges almost inevitable since the corporation has confessed its guilt and provided assistance to the Justice Department in the prosecution of the other cartel members. In order to enhance the incentives to take advantage of the amnesty and leniency program and turn against other cartel members, Congress subsequently passed legislation that provided that cooperating firms normally would only be liable for single damages for private litigation in connection with cartel activity subject to a grant of immunity under the amnesty and leniency program.¹⁶² As a result of the combined incentives of the amnesty and leniency program, the vast majority of recent large domestic and international cartel cases have originated from cartel members who have defected and disclosed the cartel to the Antitrust Division pursuant to the program.¹⁶³ At least thirty foreign jurisdictions have adopted similar programs further increasing the incentives to turn in fellow cartel members for immunity or leniency, but complicating the process of coordinating the different procedural and substantive requirements of each program.¹⁶⁴

The growth of amnesty and leniency programs is just part of the growing international consensus that price fixing, bid rigging, and related offenses should be deemed hard-core cartel offenses and should be illegal under national or regional law and vigorously investigated and punished by the relevant competition authority. For example, the thirty-plus nations of the Organization for Economic Cooperation and Development (“OECD”) recognized that hard core cartels are the most egregious violations of competition law and that effective action against hard core cartels is particularly important from an international perspective.¹⁶⁵ The 1998 OECD Recommendation

¹⁶² Antitrust Criminal Penalty Enhancement and Reform Act of 2004 Extension Act, Public Law 111-30, 123 Stat. 1775. Limitation of liability to single damages is contingent on truthful cooperation by the corporation.

¹⁶³ Hammond, *supra* note 32, at 4.

¹⁶⁴ J. Anthony Chavez, *International Cartel Enforcement: Creating a Fear of Detection*, in ANTITRUST INSTITUTE 2010: DEVELOPMENTS & HOT TOPICS, 1811 PLI/Corp 929 (2010).

¹⁶⁵ Organization for Economic Cooperation & Development, RECOMMENDATION OF THE COUNCIL CONCERNING EFFECTIVE ACTION AGAINST HARD CORE CARTELS (adopted by the Council at its 921st

advises member countries to ensure that their competition laws effectively halt and deter hard core cartels by providing for effective sanctions and adequate enforcement procedures and institutions to detect and remedy hard core cartels.¹⁶⁶

Most of the major competition law jurisdictions now take a similar tough stance on cartel activity. Although the European Union does not criminalize cartel activity or impose individual liability, it does impose fines of up to 10% of the world-wide annual turnover of the enterprises involved.¹⁶⁷ These fines often have equaled or exceeded the criminal fines imposed by the United States in connection with the same cartel operating in both jurisdictions.¹⁶⁸ Although penalties and the level of enforcement differ, an increasing number of countries including Canada, the United Kingdom, Ireland, Brazil, and Australia, are enacting and enforcing criminal price fixing provisions¹⁶⁹ and/or seeking to create meaningful private rights of actions for the victims of price fixing and related cartel activity.¹⁷⁰

The criminal penalties on corporations and other business entities, imprisonment of key corporate officers and employees, potential disqualification of directors, overall financial consequences, as well as collateral debarments from doing business with certain public sector customers are frequently material for the financial performance of the corporation and may be required to be reported to the SEC and disclosed to the public. This in turn raises additional concerns under federal securities regulation and increases the potential for shareholder derivative and class action litigation.

This suggests that there are unique red flags associated with the role of corporate boards in connection with cartel type activity. First, the decision to apply for leniency is normally a board decision. Second, for a board to consider, and then reject, applying for

Session on 25 March 1998 [C/M(98)7/PROV]), available at <http://www.oecd.org/dataoecd/39/4/2350130.pdf>.

¹⁶⁶ *Id.*

¹⁶⁷ Art. 23, COUNCIL REGULATION (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, O.J. L 1/1 (Jan 1, 2003).

¹⁶⁸ II ATWOOD, BREWSTER & WALLER, *supra* note 167, at § 16.2.

¹⁶⁹ Chavez, *supra* note 163, at III G.

¹⁷⁰ Commission of the European Communities, White Paper on Damages actions for breach of the EC antitrust rules, Brussels, 2.4.2008, COM(2008) 165 final, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0165:FIN:EN:PDF>.

unconditional amnesty would be condoning a criminal felony and automatically constitute a breach of the board's fiduciary duty. The business judgment rule would not protect such a decision.¹⁷¹ Board members would be exposed to significant liability in shareholder derivative litigation and conceivably as aiding and abetting the conspiracy in the underlying antitrust violation. In addition, to reject a chance at unconditional amnesty is to risk another member of the cartel having the opportunity to seek amnesty receive the benefits and place the first corporation in the difficult position of almost certainly having to defend both criminal and civil litigation with a different cartel member obliged to truthfully and fully cooperate with the government at every step of the process.

But this first scenario of outright rejection of an opportunity for amnesty is both extreme and unlikely. Intermediate scenarios include when it becomes publicly known that another member of the industry in the United States or abroad has sought or received amnesty in connection with cartel activity. Once again, it is probably too late to take action, although the possibility of a discretionary amnesty application (or application in another jurisdiction) is still available. However, in the real world, amnesty is probably too late and the board's choice is to contest liability if the facts and law warrant or to seek a guilty plea with a reduced sentence and fine as the only practical alternative.

Other real world variations of potential red flags for board consideration include the execution of a search warrant or dawn raid of company premises, the receipt of a grand jury subpoena, the receipt of a civil investigative demand, press reports of grand jury or civil antitrust investigations, the filing of a civil class action, individual treble damage, or civil governmental cases, a history of prior antitrust violations, the receipt of a demand letter threatening litigation, disturbing results from an antitrust audit or other internal investigation or compliance program, the surfacing of an internal whistleblower, customer complaints of anticompetitive conduct, and so on down to unsubstantiated rumor and innuendo. In most of these variations, the more likely scenario is that a corporate board was not aware of the cartel activity or the corporation's participation in the cartel until it is too late. But the question for corporate governance, corporate

¹⁷¹ FANTO, DIRECTORS' AND OFFICERS' LIABILITY, *supra* note 16, at § 2.23(c); ALI Principles, *supra* note 21, at § 4.01.

compliance, corporate responsibility, and director liability is what should the board have known and when should they have known it.

Even in the absence of these legal and regulatory red flags, there are business, economic, and industry factors should trigger at least reflection by a corporate board whether something more needs to be done. Antitrust economists are in broad agreement that some of the industry dynamics that are prone to collusion include a small number of players, a homogenous product, price transparency, widespread exchange of information among competitors, heavy contacts between competitors in a trade association or other context, and/or signaling through the press and public announcements about future pricing and production.¹⁷² When such factors are part of the daily life of the corporation and its competitors willful ignorance should not be a shield for liability.

Cases like *Caremark* and *Stone* establish that the corporation should have meaningful effective compliance programs and the board should be aware of those programs and involved such that the compliance program functions properly. No case suggests that the mere fact that illegal activity occurred, by itself, constitutes a breach of the board's duties toward the shareholder no matter how dire the consequences to the corporation or the shareholders. And yet, something more than setting up a compliance program in good faith and then ceasing to pay attention is required.

However, the danger is that the current legal structure creates incentives to engage in what Daniel Sokol has dubbed "cosmetic compliance."¹⁷³ The risk is that the corporations will engage in just enough compliance efforts to avoid legal liability but not enough to actually detect anything, lest the board then be required to actually do something about it in order to avoid liability.¹⁷⁴

The federal criminal sentencing guidelines provide some additional guidance.¹⁷⁵ These sentence guidelines were at one time mandatory, but now serve as voluntary guidelines to reduce sentencing

¹⁷² DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 217-228 (1990).

¹⁷³ D. Daniel Sokol, *Cartels, Corporate Compliance and What Practitioners Really Think About Public and Private Enforcement*, 77 ANTITRUST L.J. xx (2010)(forthcoming).

¹⁷⁴ Sokol, *Cartels*, *supra* note 172, at *45 & n. 269.

¹⁷⁵ Federal Sentencing Guidelines Manual 2009, available at <http://www.ussc.gov/2009guid/TABCON09.htm>.

disparities for all federal criminal offenses.¹⁷⁶ They indicate that the existence (or lack thereof) an effective compliance and ethics program will affect the culpability score of the corporate defendant which will in turn affect the amount of the applicable criminal fine for all federal corporate criminal convictions including antitrust.¹⁷⁷ In addition the maintenance of an effective compliance and ethics program normally also will be a term of the probation of a corporate defendant.¹⁷⁸

In order to qualify as an effective compliance and ethics program, the organization must:

- 1) Exercise due diligence to prevent and detect criminal conduct; and
- 2) Otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.¹⁷⁹

Due diligence in this context means that the board of directors, as the governing authority of the corporation “shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.”¹⁸⁰ After establishing and promoting the program, the organization must also take reasonable steps to make sure that the program is being followed (including monitoring and auditing), periodically evaluating the program, utilizing statistical screening techniques of company data, creating mechanisms for the anonymous and/or confidential reporting of violations, and taking reasonable steps to respond appropriately to criminal conduct.¹⁸¹ Together, these requirements lay out a road map, but not an instruction manual, for corporate boards which are serious about effective compliance in the cartel context and other areas of federal criminal law for corporations.

¹⁷⁶ United States v. Booker, 543 U.S. 220 (2005).

¹⁷⁷ Federal Sentencing Manual, *supra* note 174, at § 882.1.

¹⁷⁸ *Id.* at § 882.1.

¹⁷⁹ *Id.* at § 882.1(a)(1-2).

¹⁸⁰ *Id.* at § 882.1(b)(2).

¹⁸¹ *Id.* at § 882.1(5-7); see also Rosa M. Abrantes-Metz, Patrick Bajari & Joseph E. Murphy, *Antitrust Screening: Making Compliance Programs Robust*, available at <http://ssrn.com/abstract=1648948>.

There also is the possibility of director disqualification. While SEC regulations bar any unfit person from serving in an executive position in a publicly held company,¹⁸² no such explicit statutory authority exists in the antitrust area in the United States. However, director disqualification for competition law violations is subject to statute in the United Kingdom and elsewhere.¹⁸³ In the 2002 UK Enterprise Act, there is the possibility of the Office of Fair Trading applying for a Competition Disqualification Order in addition to the other penalties provided for violation of the UK or EU competition rules.¹⁸⁴ Here too, the ultimate test is whether the director is unfit to manage a company.¹⁸⁵

The OFT recently has issued revised guidelines indicting when they are likely to use these provisions in the future.¹⁸⁶ Normally, the OFT will require a prior definitive decision that a competition violation¹⁸⁷ has occurred, although it has the power in exceptional circumstances to proceed even in the absence of a prior violation.¹⁸⁸ The guidelines also suggest that director disqualification normally will be sought only for the more serious competition violations.¹⁸⁹

While the director disqualification process is likely to be used for situations where the director has actively participated in the violation, the more interesting sections of the guidelines pertain to those directors who “ought to have known” about the violations.¹⁹⁰ While no bright line rule is possible, the OFT will take into account such factors as the director’s role, position, knowledge, skill, experience, responsibilities and available information, as well as the relationship between those roles and factors and the persons

¹⁸² Sarbanes-Oxley Act of 2002 § 305, 15 U.S.C. § 78u(d)(2) (2006).

¹⁸³ Company Directors Disqualification Act, 1986, ch. 46, S9A-E; Canadian Business Corporations Act, R.S.C., 1985 c. C-44. *See also* Jasmine Girgis, *Corporate Directors’ Disqualification: The New Canadian Regime?*, 46 ALBERTA L. REV. 8-9 (2009), available at <http://ssrn.com/abstract=1346589>; Johannes Schmidt, *The Case for a European Competition Disqualification Order*, abstract available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1761509.

¹⁸⁴ Article 204, Enterprise Act 2002, c. 40, Article 204 (U.K.).

¹⁸⁵ *Id.*

¹⁸⁶ Office of Fair Trading, *Director Disqualification Orders in Competition Case: An OFT Guidance Document* (2010), available at http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/oft510.pdf.

¹⁸⁷ *Id.* at § 4.6.

¹⁸⁸ *Id.* at § 4.7.

¹⁸⁹ *Id.* at § 4.11.

¹⁹⁰ *Id.* at § 4.22.

responsible for the violations.¹⁹¹ While this is not inconsistent with the general guidelines provided by cases like *Caremark*,¹⁹² it is more specific, more focused on competition issues, and represents a middle ground between draconian personal liability and virtual immunity under the US business judgment rule.

There are no equivalent statutes or guidelines in the United States for competition offenses. Seeking such a statutory amendment would be helpful, but appears to be politically unrealistic. Even in the absence of specific statutory authority, there is the possibility of barring certain directors, officers and employees from the company or industry for varying lengths of time as part of court judgment and consent decrees for fraud and serious regulatory violations.¹⁹³ From time to time, guilty pleas in antitrust cases have included similar language, but no systematic practice or plan appears to be at work.¹⁹⁴ Formal or informal versions of the UK statute and OFT guidelines would go a long way to filling the void left by state and federal law when corporate boards have failed to act because they failed to notice that anything was amiss until it was too late. As Douglas Ginsburg and Joshua Wright further note, increasing personal responsibility (rather than corporate fines) may be the only way to both increase deterrence and minimize agency costs.¹⁹⁵

¹⁹¹ *Id.* In addition, the guidance indicate that the OFT normally would not seek disqualification of any director of a company which has benefitted from leniency. *Id.* at 4.12. The OFT reserves the right to seek disqualification if the director was personally involved in the offense, opposed the amnesty application, or failed to cooperate with the resulting investigation. *Id.* at § 4.14.

¹⁹² *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959 (1996).

¹⁹³ See 15 U.S.C. § 77t(e); *id.* § 78u(d)(2). *SEC v. Florafax Int'l, Inc.*, Lit Rel. 10617, 31 SEC Docket 1425 (N.D. Okla. 1984) (three year bar on consent without admitting liability); *SEC v. Farrell*, 1996 WL 788367 at 8*. Plaintiffs' Motion to Enter Revised Permanent Injunction and Final Order as to Defendant Tarzenea Dixon, *FTC v. Your Money Access, LLC.*, No. 2:07-CV-05147-ER. (E.D. Pa. Dec. 22, 2009), 2009 WL 5177847 (permanently enjoining a defendant individual from payment processing, including ACH debits and credit card transactions); Consent Decree, No. 02-5115 (C.D. Cal. (July 8, 2002), available at <http://www.ftc.gov/os/2002/07/dcsconsent.pdf> (permanently enjoining from debt collection and assisting in debt collection activities); Stipulated Judgment & Order for Permanent Injunction, No. 02-cv-01256 (D. Ariz. (Feb. 6, 2003) (enjoined from telemarketing and assisting or facilitating telemarketing).

¹⁹⁴ *Hoecht Celanese Corp.*, 1991 WL 639945, at *19 (FTC Aug. 23, 1991).

¹⁹⁵ Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Sanctions*, COMP. POL'Y INT'L. (forthcoming 2010).

Another key appears to be in the creation of a meaningful compliance program both for antitrust and other legal and regulatory risks.¹⁹⁶ Although theoretically having a compliance program and then violating it could cut against a corporation or director, in practice it does not work that way. Both the US sentencing guidelines and the OFT director disqualification guidelines provide benefits and protections to corporations that have such programs and do not impose special burdens on the officers and directors who create or supervise those good faith compliance programs.

The ultimate question is what types of cartel red flags should a board ignore at its peril? When ought a board to know that something is amiss? What should be the penalties if they violate these duties? No bright line rules emerge for the honest and well meaning board member that has not actually participated in the violation. However, the case law leaves much to be desired and comparisons with foreign practice and other areas of US law enforcement and regulatory experience require particularization for the competition area.

At a minimum, directors need to be aware of the per se illegality and penalties for price fixing, bid rigging, market division, customer allocation and similar cartel activity. No officer or director can participate in such activity, cover up in such activity, or knowingly allow any person to do so on behalf of the company. Board members must create meaningful corporate compliance programs, relying on trained professionals, to deter, prevent, and detect such activity and ensure that such programs are instituted and taken seriously at every level of the corporation. Training must be regular and ongoing at all levels of the corporation. Compliance audits, screening techniques, and revisions to the compliance program will be required from time to time. Whistleblowers must be encouraged and not punished. Credible complaints of wrongdoing from any source must be taken seriously. Prompt action by the board will be required if credible allegations of violations appear from any of these sources.

When such vigilance is present, then board members should be protected from personal liability and the corporation from shareholder litigation when genuinely unexpected violations prove to have

¹⁹⁶ *SEE GENERALLY* THEODORE L. BANKS, *CORPORATE LEGAL COMPLIANCE HANDBOOK* (2002).

occurred. When such vigilance is lacking, officers, directors, and corporations should not be able to hide behind overly generous protections from state corporate law doctrines designed to address more mundane duties and harms.

D. Governance and the Rule of Reason

Corporate governance issues affect a host of other issues also governed by Section 1 of the Sherman Act. Any agreement which unreasonably restricts competition is unlawful under Section 1. As discussed above, only a handful of agreements are per se unreasonable and normally prosecuted criminally. The rest are judged under a broader rule of reason analysis on a case-by-case basis and are the subject of civil litigation if challenged by either the government or private parties.

Corporate governance issues arise both as to whether there is even an agreement between two economically independent economic actors and whether any such agreements unreasonably restrict competition. For example, most sports leagues are comprised of individual franchises owned by competing owners or groups. These economically independent (but interdependent) teams compete both on the field and off the field economically, but cooperate in the creation and maintenance of the league itself. As a result most sports leagues are subject to normal antitrust review unless protected by a statutory or judicial immunity.¹⁹⁷

In contrast, several professional sports leagues have organized themselves as single entities owning all franchises and player rights in order to avoid even constituting a “contract, combination or conspiracy” within the meaning of Section 1 of the Sherman Act. The most prominent of these peculiar structures for a sports league

¹⁹⁷ *Brown v. Pro Football, Inc.*, 518 U.S. 231 (1996)(particular practices of NFL immune from antitrust laws under labor exemption); *NCAA v. Board of Regents*, 463 U.S. 1311 (1984)(NCAA television rules subject to Section 1 of the Sherman Act but should be judged under truncated version of rule of reason); *Radovich v. National Football League*, 352 U.S. 445 (1957)(NFL enjoys no special antitrust immunity); *Federal Baseball Club v. National League*, 259 U.S. 200 (1922)(professional baseball not interstate commerce and therefore beyond scope of commerce clause and Sherman Act; *Fishman v. Estate of Wirtz*, 807 F.2d 520, 553 (7th Cir.1986)(holding late owner of Chicago NBA franchise liable under Sherman Act).

premised on competition between teams was Major League Soccer which switched to a more traditional ownership structure several years after its creation over concerns that the relative lack of success of the business model in comparison to the minimal risks associated with being subject to Section 1 of the Sherman Act.¹⁹⁸ Similar issues were raised in the recent Supreme Court *American Needle* decision where NFL Properties and its licensing operations was held to be an agreement within the meaning of Section 1 since it involved decisions by economically independent actors.¹⁹⁹

Corporate governance can also affect not just whether Section 1 of the Sherman Act applies, but what test will be applied in judging the legality of the agreement. The Supreme Court in its unanimous decision in *American Needle* was clear that some types of agreements are necessary in order to create professional sports and other joint enterprises in the first place.²⁰⁰ As a result some form of the rule of reason must be applied to such agreements and most will be held not to unreasonably restrict competition after a full examination of the pro- and anti-competitive aspects of the particular agreement.²⁰¹

These types of corporate governance issues came to the forefront of antitrust in the Visa/MasterCard litigation brought by both the federal government and in massive private treble damage antitrust class actions. While the governance arrangements within and between Visa and Mastercard have been characterized as cartels,²⁰² the reality is more complex.

Both Visa and Mastercard were created as networks owned and operated by the member banks. Both associations had boards of directors heavily weighted toward the largest banks issuing that particular credit card, which were often the same set of banks. Each association had by-laws that permitted banks to issue both Visa and

¹⁹⁸ See generally Chris Sagers, *American Needle, Dagher, and the Evolving Antitrust Theory of the Firm: What Will Become of Section 1?*, ANTITRUST SOURCE 1 (August 2009).

¹⁹⁹ *Am. Needle, Inc. v. Nat'l Football League*, __ U.S. __, 130 S.Ct. 2201, available at <http://www.supremecourt.gov/opinions/09pdf/08-661.pdf> (May 24, 2010).

²⁰⁰ __ U.S. at __, 130 S.Ct. 2201, available at <http://www.supremecourt.gov/opinions/09pdf/08-661.pdf> (May 24, 2010).

²⁰¹ Herbert J. Hovenkamp, *American Needle and the Boundaries of the Firm*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616625; Spencer Weber Waller, *Justice Stevens and the Rule of Reason*, 62 SMU L. REV. 693 (2009).

²⁰² See e.g., LLOYD CONSTANTINE, PRICELESS: THE CASE THAT BROUGHT DOWN THE VISA/MASTERCARD BANK CARTEL (2009).

Mastercard cards, but prohibited banks from issuing any other credit cards, such as Discover or American Express. The Antitrust Division challenged this governance structure as a civil rule of reason violation of Section 1 of the Sherman Act and sought injunctive relief. The Second Circuit ultimately held this practice unlawful under the rule of reason.²⁰³

In addition to complying with the terms of the judgment in the government case, Mastercard also fundamentally altered its ownership and governance structure through a subsequent initial public offering of stock. At least part of the strategy behind the Mastercard initial public offering was an attempt to further reduce antitrust exposure by changing the fundamental nature of the entity from a cooperative enterprise run by competitors into a single economic actor owned by its share holders with the former member banks having no day-to-day control over network policies and operations.²⁰⁴

The IPO established a relatively unusual governance structure which gives member banks more economic exposure than voting rights, “flipping the usual dual-class voting structure upside-down.”²⁰⁵ Despite these helpful changes, numerous other policies and pricing decisions of the Visa and Mastercard networks have also been the subject of continued private antitrust challenge.²⁰⁶

²⁰³ United States v. Visa U.S.A., 344 F. 3d 229 (2d Cir. 2003).

²⁰⁴ Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, 12 HARV. NEG. L. REV. 137 (2007); Joshua Wright, *Mastercard's Single Entity Strategy*, 12 HARV. NEG. L. REV. 225 (2007).

²⁰⁵ Fleischer, *supra* note 204, at 138. The IPO also established a charitable foundation which holds a significant block of Mastercard stock which Professor Fleischer contends provides both takeover protection and also gives the member banks continuing influence without antitrust exposure. *Id.*

²⁰⁶ In addition, to the government case discussed above, Visa and Mastercard have been subject to substantial private treble damage antitrust litigation relating to the interchange fees they charge merchants, requirements that merchants accept both credit and debit cards, and separate policies that required merchants not to impose their own fees for processing credit or debit transactions or providing discounts for cash purchases. The largest of these private cases settled for approximately \$3 billion. See CONSTANTINE, *supra* note 202. For an overview of these antitrust issues see Steven Semeraro, *The Antitrust Economics (and Law) of Surcharging Credit Card Transactions*, 14 STAN. J. L. BUS. & FIN. 343 (2009); Steven Semeraro, *Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*, 14 GEO. MASON L. REV. 941 (2007); Adam J. Levitan, *Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*, 12 STAN. J. L. BUS. & FIN. 425 (2007); Adam J. Levitan, *The Anti-Trust Superbowl: America's Payment Systems, No-Surcharges Rules, and the Hidden Costs of Credit*, 3 BERK. BUS. L.J. 265 (2005).

The importance of corporate governance and antitrust was also illustrated in a far less well known case. The company now known as Verisk was formed originally as Insurance Service Organization, Inc. (ISO) as a captive entity of the insurance industry and mutually owned by the leading competing firms in the industry.²⁰⁷ ISO drafted standardized language for commercial general liability insurance contracts and performed statistical and other data analyses to aid its owners, the insurers, in underwriting insurance policies. As a matter of corporate governance, ISO was managed by a board of directors comprised of eighteen insurance executives and three non-insurers.

The antitrust concerns arose out of the insurance crisis of the 1980s where insurance premiums skyrocketed and state and local governments found it impossible to obtain certain types of insurances that had been previously offered. Insurance companies and other parts of the industry insisted on more restrictive terms that limited existing coverage in different ways. Prior policy terms were no longer made available.

A coalition of state attorney generals and private parties sued US and foreign primary insurers, reinsurers, retrocessional insurance companies, and ISO for entering into a boycott and other unlawful agreements under the Sherman Act. This litigation ultimately went to the Supreme Court establishing important law as to the scope of the antitrust exemption for the insurance and the international application of the Sherman Act.²⁰⁸

As a result of the antitrust litigation, ISO entered into a consent decree with state attorneys and certain private plaintiffs in 1995 and was demutualized, creating a new ownership and governance structure that was independent from the insurers.²⁰⁹ The new board would consist of eleven members with seven non-insurers, three insurers, and one management director.²¹⁰ The new independent board would elect

²⁰⁷ Questions of antitrust liability are complicated in this context by the existence of the McCarren-Ferguson Act which creates an exemption for the business of insurance (but not boycotts) where regulated by state law. See 15 U.S.C. § 1012 (2010). See generally AMERICAN BAR ASSOCIATION, SECTION OF ANTITRUST LAW, MONOGRAPH NO. 24, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW 133-60 (2007).

²⁰⁸ *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

²⁰⁹ In re Insurance Antitrust Litigation, MDL No. 767, (settlement agreement), available at <http://www.abanet.org/antitrust/at-committees/at-state/pdf/settlements/us-district/9th-circuit/insurance.pdf>.

²¹⁰ *Id.* at ¶ 15 and Attachment I.

the future non-insurer directors and the insurer directors would elect the future insurance directors.²¹¹ The insurance industry was further barred from group participation in the affairs of ISO for a five year period.²¹²

Later renamed Verisk, the company continued to do business with the industry on a contractual basis for both drafting standard form contracts and data analysis and research.²¹³ Freed from the conflicting incentives and cumbersome governance structure, the company prospered, deepened its product offerings, entered new markets, made a number of acquisitions and transformed itself into a far more profitable and dynamic entity. By the end of 2008, the firm had annual revenues of \$894 million, with revenues for the first half of 2009 over \$500 million, in comparison to \$220 million at the time of the consent decree.²¹⁴ Profits increased substantially over the same period as well.²¹⁵ This in turn led to a successful initial public offering in October 2009,²¹⁶ providing further indication that good competition policy and good corporate governance can go hand in hand.

E. Mergers and Acquisitions

In terms of the duties of the board, mergers fall somewhere closer to the need for vigilance against cartel activity and the relatively back seat role in terms of guarding against unlawful monopolization and abuse of dominance. It is the traditional province of the board to carefully review any significant acquisitions outside the ordinary

²¹¹ *Id.*

²¹² *Id.* at ¶ 13.

²¹³ See Form S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 VERISK ANALYTICS, INC. (Aug. 12, 2008), available at <http://sec.gov/Archives/edgar/data/1442145/000095012308009387/v65055sv1.htm>.

²¹⁴ Amendment No. 7 to Form S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 VERISK ANALYTICS, INC. (Sept. 29, 2009), available at <http://sec.gov/Archives/edgar/data/1442145/000095012309046968/0000950123-09-04968-index.htm>; *Antitrust Suit by 20 Attorneys General Ends with Agreement to Remove Insurer Control over Key Data Organization*, PR Newswire (Oct. 6, 1994), available at http://global.factiva.com/aa?ref+prn0000020011030dqa601gzf&pp+1&fcpl=en&nape=S&sa_from=.

²¹⁵ Form S-1, *supra* note 213.

²¹⁶ Amendment No. 7 to Form S-1, *supra* note 214.

course of business.²¹⁷ The board also is required to authorize any change in control of the corporation.²¹⁸ In addition to questions of fairness and valuation of any acquisition, the board would normally be informed of any significant legal risks, including antitrust issues, in the proposed merger or acquisition and take those considerations into account in making its overall determination in approving or rejecting the transaction.²¹⁹

The antitrust remedy for an unlawful merger normally is the prospective blocking of the merger prior to closing or its restructuring to eliminate the effect on competition.²²⁰ Under this scenario, the planning and organization of the transaction obviously entail costs to the corporation as does the pre-merger notification and investigation of the transaction. However, even the abandonment of the merger in the face of an inevitable antitrust challenge or the unsuccessful litigation of a court challenge does not involve imprisonment, criminal or civil fines, or even treble damages under most normal circumstances. While treble damages are theoretically possible for any person who has been injured in their business or property as a result of an antitrust violation, it is difficult to conceive of who could be so injured by a merger which was never consummated. The federal government, state attorney generals, and private parties do however retain the right to challenge an unlawfully anticompetitive merger after consummation with the attendant disruptions and costs of unscrambling the omelet.²²¹ But again, such litigation is rare, almost never successful by anyone other than the federal government, and the possibility of damages remote.

Antitrust analysis for mergers and acquisitions is complicated and contingent on questions of market definition, market power, often technical theories of anticompetitive harm, the likelihood of market entry to offset potential harm, likely efficiencies, and occasionally, whether one or both of the merger parties constitute “failing firms.”²²² This is normally beyond the expertise of the board and often dependent on market facts outside control of corporation or even its merger partner.

²¹⁷ FANTO, DIRECTORS AND OFFICERS, *supra* note 16, at § 5.3.

²¹⁸ *Id.* at § 5.3.1.

²¹⁹ Moore Corp. v. Wallace Computer Serv’s, Inc., 907 F. Supp. 1545 (D. Del. 1995)(construing Delaware state law).

²²⁰ 18 U.S.C. § 18a(f).

²²¹ California v. American Stores Co., 495 U.S. 271 (1990).

²²² 2010 Horizontal Merger Guidelines, *supra* note 40, *passim*.

However, there is mounting evidence from corporate finance community that suggests entire categories of deals are fraught with peril and more likely to destroy, rather than enhance, shareholder value. A growing body of both empirical and theoretical literature has questioned the premises and results of an unconstrained market for corporate control being necessary or sufficient to solve the agency cost problems of corporate governance or create greater efficiency warranting deferential antitrust review of these same mergers. Certain of this literature comes from the corporate finance and accounting fields. Other sources come from the growing field of behavioral economics as applied to antitrust and finance.²²³ Together these sources and studies strongly suggest that certain categories of mergers destroy shareholder value and do little if anything to create meaningful efficiencies or enhance market competition. At a minimum corporate governance and antitrust policy should be harmonized to strongly scrutinize and question transactions which work at cross-purposes to both bodies of law.

The corporate finance literature has suggested that certain identifiable categories of mergers typically destroy, rather than enhance, shareholder value. Michael Jensen, a noted finance professor, observed relatively early on that value destroying mergers are more likely when managers of firms have unused borrowing power and large free cash flows.²²⁴ This is yet another illustration of the problem of agency costs and the tendency for managers to invest in below average or even value destroying mergers, rather than other investments and payouts that are more beneficial to shareholders.

Professor James Fanto has summarized numerous studies from the more recent corporate finance literature to conclude that mega-mergers of roughly equal firms financed through stock-for stock mechanisms are another type of transaction that is particularly suspect

²²³ See generally Amanda Reeves & Maurice Stucke, *Behavioral Antitrust*, 86 INDIANA L. J. xx (2011)(Univ. of Tenn. Legal Studies Research Paper No. 106), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1582720; Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. PENN. L. REV. 261 (2010); *Behavioral Economics: Observations Regarding Issues That Lie Ahead*, Outline of Remarks of J. Thomas Rosch, Commissioner, Federal Trade Commission before the Vienna Competition Conference, Vienna, Austria (June 9, 2010).

²²⁴ Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. ASSOC. PAPERS & PROC. 323 (1986).

for destroying shareholder value.²²⁵ While the ill-fated AOL-Time Warner merger is the poster child for this type of transaction and unfortunate outcome,²²⁶ it is hardly alone. Professor Fanto has identified numerous mergers such as Travelers-Citicorp, US West-Qwest, and others as further examples of this trend.²²⁷ Fanto also notes that mergers dependent on poorly articulated synergies are also particularly suspect for their value destroying tendencies.²²⁸

More recent studies have confirmed these dismal conclusions.²²⁹ A 2005 study by Moeller, Schlingemann and Stulz found that “from 1991 to 2001 (the 1990s) acquiring firms’ shareholders lost an aggregate \$216 billion, or more than 50 times the \$4 billion they lost from 1980 to 1990 (the 1980s), yet firms spent just 6 times as much on acquisitions in the later period.”²³⁰ Most of the studies that suggest that mergers in general may create value focus on short-term changes in stock valuations of the acquired and acquiring companies following the public announcement of the transaction. These studies are not surprising since the acquired corporation’s stock is likely to increase in value given that the acquisition price is frequently a premium of the current stock price. This increase is often greater than any decrease of the acquiring company’s stock price leading certain finance scholar’s to conclude that mergers (properly

²²⁵ Steven Lipin & Nikhil Deogun, *Big Mergers of the 90s Prove Disappointing to Shareholders*, WALL ST. J., Oct. 30, 2000.

²²⁶ Andrew Edgecliffe-Johnson, *Ex-Time Warner chief apologises for ‘the worst deal of the century’*, ft.com (Jan. 5, 2010); Tim Arango, *How the AOL-Time Warner Went So Wrong*, available at <http://www.nytimes.com/2010/11/business/media/11merger.html?hpw> (Jan. 10, 2010).

²²⁷ James A. Fanto, *Braking the Merger Momentum: Reforming Corporate Law Governing Mega-Mergers*, 49 BUFF. L. REV. 249 (2001); James A. Fanto, *Quasi-Rationality in Action: A Study of Psychological Factors in Merger Decision Making*, 62 Ohio St. L.J. 1333 (2001).

²²⁸ Fanto, *Braking the Merger Momentum*, *supra* note 227, at 279.

²²⁹ Dinara Bayazitova & Matthias Kahl & Rossen Valkanov, *Which Mergers Destroy Value? Only Mega-Mergers*, available at <http://ssrn.com/abstract=1502385>.

²³⁰ Sara B. Moeller, Frederik P. Schlingemann & Rene M. Stultz, *Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns on the Recent Merger Wave*, 60 J. FIN. 757 (2005). The study further notes that acquiring firm shareholders gained \$24 billion from 1991 through 1997 before losing \$240 billion from 1998 to 2001. *Id.* at 758-59. The authors further conclude that the large losses from 1998 through 2001 cannot be explained by a wealth transfer from acquiring firm shareholders to acquired-firm shareholders. *Id.* at 759.

controlled for other variables) are efficiency enhancing and value enhancing.²³¹

Longer term studies of the actual performance of the deal years down the road reach very different conclusions. At a minimum, there is no significant support for the claim of broad efficiencies in the overall market for mergers.²³² Too high a percentage of mergers and acquisitions end badly to take comfort in an unregulated market for corporate control as the answer to either the agency cost problem in corporate governance or the pursuit of an efficient competitive market for antitrust purpose. Nor do these studies cast any doubt on the more particularized claims of Fanto and others that stock-for-stock mega-mergers of equals remain the most suspect category of corporate transactions likely to produce massive wealth destruction for shareholders.

Studies by the Federal Reserve Bank and other business scholars have suggested that there may be slightly different results for financial and banking mergers versus those in the industrial sector.²³³ An analysis by Federal Reserve Bank staff of over 250 prior studies suggests that mergers in the finance and banking sector increased market power, produced no meaningful cost efficiencies, some efficiencies in payment systems, and some increased systematic risk.²³⁴ However, even in the banking sector sound governance mechanisms can be helpful in preventing bank executives from pursuing value destroying acquisitions.²³⁵

Corporate governance principles as well as behavioral economics go a long way to explaining why corporations would consistently engage in behavior that is so harmful to shareholder

²³¹ See e.g., Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21 (1998).

²³² See D.J. RAVENCRAFT & F.M. SCHERER, *MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY* (1987); F.M. Scherer, *A New Retrospective on Mergers*, 28 REV. IND. ORG. 327 (2006); Dennis Mueller, *The Finance Literature on Mergers: A Critical Survey*, IN COMPETITION, MONOPOLY AND CORPORATE GOVERNANCE 161 (M. Waterson ed. 2003).

²³³ See generally FEDERAL RESERVE SYSTEM, *THE INTERNATIONAL FINANCE DISCUSSION PAPERS NO. 679: THE IMPACT OF BANK CONSOLIDATION ON COMMERCIAL BORROWER WELFARE* (2000); Allen N. Berger & Rebecca S. Demsetz & Strahan, *The Consolidation of the Financial Services Industry: Causes, Consequences and Implications for the Future*, 23 J. BANKING & FIN. 135 (1999).

²³⁴ Berger, Demsetz & Strahan, *supra* note 233, at 154-55, 173-74.

²³⁵ Jens Hagendorff, Michael Collins & Kevin Keasey, *Bank Governance and Acquisition Performance*, 15 CORP. GOV.: AN INT'L REV. 957 (2007).

interest. The central insight going all the way to Berle and Means is that the incentives of officers and directors are not well aligned with those of shareholders. Many scholars have focused on the incentives and rewards for corporate decision makers (the officers and particularly the CEO) to explain sub-optimal decisions and the continued biases toward mergers even when they are not value enhancing. Studies from the 1980s through the present show a tendency of management to pursue acquisitions not in their shareholder interests in order to enhance their employment security, build empires, or simply expand the perquisites of office.²³⁶

A variant of this explanation focuses on CEO autonomy, hubris, overconfidence, and narcissism as key explanations of the pursuit of mergers which both end poorly and can be predicted to do so.²³⁷ Similarly, weak corporate governance, lack of information, and the continued misaligned interests of directors beholden to corporate insiders suggest that the board of directors will not typically be in a position to stop these suboptimal acquisition plans once embarked upon by a powerful CEO.²³⁸

²³⁶ Julie Wulf, *Do CEOs in Mergers Trade Power for Premium? Evidence from "Mergers of Equals"*, 20 J. L. ECON. & ORG. 60 (2004); R. Morck, A. Schliefer, & R.W. Vishny, *Do Managerial Objectives Drive Bad Acquisitions?*, 45 J. FIN. 31 (1990); Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, J. BUS. 197 (1986); Y. Amihud & B. Lev, *Risk Reduction as a Managerial Motivation for Conglomerate Mergers*, 12 RAND J. ECON. 605 (1981).

²³⁷ Bayazitova, et al, *supra* note 229; Nihat Aktas, Eric de Boldt, Helen Bollaert & Richard Roll, *CEO Narcissism and the Takeover Process*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1638972; Ulrike Malmendier & Geoffrey Tate, *Who Make Acquisitions? CEO Overconfidence and the Market's Reaction*, 89 J. FIN. ECON. 20 (2008); F.M. Scherer, *A New Retrospective on Mergers*, 28 REV. IND. ORG. 327, 337 (2006)("[W]e in the US have created a sizeable professional establishment that sees as a significant justification for its existence the making of mergers."); Fanto, *Braking the Merger Momentum*, *supra* note 227, at 251-57; Mathew L.A. Haywards & Donald C. Hambrick, *Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris*, 42 ADMIN. SC. Q. 103 (1997). See generally Steven A. Ramirez, *Lessons from the Subprime Debacle: Stress Testing CEO Autonomy*, 53 ST. LOUIS L. REV. 1 (2009); Steven A. Ramirez, *The End of Corporate Governance Law: optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. L. & REG. 313, 334 (2007); Steven A. Ramirez, *The Special Interest Race to CEO Primacy and the End of Corporate Governance Law*, 32 DEL. J. CORP. L. 345 (2007) (each describing and critiquing trend toward CEO primacy, autonomy, and hubris).

²³⁸ Shail Pandit, *Do Bad Boards Make Bad Acquisitions?*, available at <http://ssrn.com/abstract=1340514>.

Behavioral economics also provides additional insight into why even well-meaning CEOs as the key players in this process may behave in such a fashion. Behavioral economics documents through empirical research how actual human beings behave “quasi-rationally” rather than as the purely rational profit-maximizing entities assume in most traditional law and economics analyses.²³⁹ Instead of the purely rational profit maximizing individual or organization as posited by the rational choice theorists, behavioral economics seeks to document that decision makers tend to act with bounded rationality, bounded willpower, and bounded self-interest.²⁴⁰

This behavioral research documents how both consumers and business decision makers are prone to predictable biases and use known heuristics and other shortcuts that produce sub-optimal decisions in the real world. Some of the well-known biases and heuristics relevant to the decision to enter in mergers and acquisitions which frequently result in value destroying transaction include

²³⁹ See e.g., AMOS TWERSKY & DANIEL KAHNEMANN, *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES*, IN *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* 3 (Kahnemann et al eds. 1982); Daniel Kahnemann, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449-75 (2003); Richard H. Thaler & Sendhil Mullainathan, *Behavioral Economics*, In *INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL AND BEHAVIORAL SCIENCES* (Neil Smelser & Paul Bates eds. 2001); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Sciences: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000); Christine Jolls, Cass Sunstein & Richard H. Thaler, *A Behavioral Approach to law* 7 Economics, 50 Stan. L. Rev. 1471 (1998); Daniel Kahnemann, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990); Amos Twersky & Daniel Kahnemann, *The Framing of Decisions and the Psychology of Choice*, SCIENCE 211, 453-58 (1981). For applications of behavioral economics to legal and regulatory policies aimed at a general audience see RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS* (2009); RICHARD H. THALER, *THE WINNER’S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* (1994).

For examples of behavioral economics as applied to antitrust see Tom Rosch, *supra* note 213; Leslie, *Trust*, *supra* note 139; Maurice Stucke, *Behavioral Economists at the Gate: Antitrust in the Twenty-First Century*, 38 LOY. U. CHI. L.J. 513 (2007); Reeves and Stucke, *Behavioral Antitrust*, *supra* note 223; Avishalom Tor, *The Fable of Entry: Bounded Rationality, Market Discipline, and Legal Policy*, 101 MICH. L. REV. 482 (2002). Not all commentators view behavioral economics as a viable addition to antitrust analysis. Gregory J. Werden & Luke Froeb, & Mikhael Shor, *Behavioral Antitrust and Merger Control*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1612282.

²⁴⁰ Stucke, *Behavioral Economists*, *supra* note 239, at 527.

myopia, loss aversion, endowment effects, status quo bias, extremeness aversion, over-optimism, hindsight bias, anchoring heuristics, availability heuristics, framing effects, representative bias, saliency effects, and others.²⁴¹ One does not have to stretch to find numerous acquisitions driven by corporate decision makers suffering from over-optimism combined with numerous other all-too human tendencies to produce poorly conceived or over-priced acquisitions dependent on future synergies and efficiencies that were unachievable in the real world. Richard Thaler has described these types of outcomes more generally as the Winner's Curse.²⁴²

Professor James Fanto surveys the securities filings for the ten largest mergers and acquisitions for 1998, 1999, and 2000 and concludes that most of these biases are present in the statements that managers and board members relied upon, were legally bound by, and/or used to persuade shareholders to approve the very largest transactions of those years.²⁴³ Most of these transactions were in turn among the most significant value destroying deals of their eras.²⁴⁴

The Moeller, Schlingemann & Stulz 2005 study notes that most of the largest value destroying acquisitions were the last in a series of acquisitions by the acquiring firm.²⁴⁵ This further suggests that the behavioral economics factor identified by Fanto and others, such as over-confidence, hind sight bias, and framing effects have played an important role in the destruction of shareholder wealth.

These all too human tendencies combined with broad CEO autonomy and hubris produce incentives to pursue certain mergers and acquisitions which benefit no one other than senior management. At the same time, a passive board of directors generally lacking in information and resources to challenge senior management similarly creates incentives to approve transactions which benefit few other than senior management.

²⁴¹ Fanto, *Quasi-Rationality*, *supra* note 227; Stucke, *Behavioral Economists*, *supra* note 239, at 527-28.

²⁴² RICHARD H. THALER, *THE WINNER'S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* (1992); Roll, *Hubris*, *supra* note 236, at 200 (CEO hubris leading to overpayment by acquiring corporation).

²⁴³ Fanto, *Quasi-Rationality*, *supra* note 227, at 1380.

²⁴⁴ Fanto, *Quasi-Rationality*, *supra* note 227, at 1375-76. *See also* Aktas, et al, *supra* note 237, at 24; Steven Lipin & Nikhil Deogun, *Big Mergers of the 90s Prove Disappointing to Shareholders*, Wall St. J., Oct. 30, 2000.

²⁴⁵ Moeller, Schlingemann & Stulz, *supra* note 230, at 781.

Behavioral economics also provides additional insights into the critical issue of entry in the market where the merger has occurred. Once the government (or other plaintiff) has established that the merger is likely to produce anticompetitive effects,²⁴⁶ they have established a prima facie case that the transaction has violated Section 7 of the Clayton Act. The defendants may then rebut the plaintiff's prima facie by showing that the merger nonetheless is unlikely to substantially harm competition.²⁴⁷

The most typical evidence is that entry barriers to the affected market are so low that any post-merger price increase would be ineffective as a result of inducing timely, effective entry that would be profitable at even pre-merger prices.²⁴⁸ Professor Avishalom Tor has discussed how the insights of behavioral economics demonstrate that post-entry entry may be more prevalent than normally assumed, but it usually is less effective in disciplining the post-merger exercise of market power than normally believed.²⁴⁹ Conversely, Maurice Stucke provides numerous examples where even admittedly moderate low entry barriers are insufficient to prevent the exercise of market power.²⁵⁰

Even accepting the need for a robust market for corporate control suggests the need for a continued antitrust presence that has been minimized in recent times. If shareholders are going to receive maximum value, this requires rules which forbid collusive bidding for firms and limit the termination of auctions for firms once in play.²⁵¹ It

²⁴⁶ *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963); *F.T.C. v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

²⁴⁷ *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); 2010 Horizontal Merger Guidelines, *supra* note 40, at §§ 8-11.

²⁴⁸ *United States v. Waste Mgmt., Inc.*, 743 F.2d 976 (2d Cir. 1984); *United States v. Baker Hughes*, 908 F.2d 981 (D.C. Cir. 1990); 2010 Horizontal Merger Guidelines, *supra* note 40, at § 9. Proof by the defendants of substantial merger specific efficiencies that offset any anticompetitive harm will also rebut a prima facie violation of Section 7. *FTC v. H. J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

²⁴⁹ Avishalom Tor, *The Fable of Entry: Bounded Rationality, Market Discipline, and Legal Policy*, 101 MICH. L. REV. 482 (2002). Brand management and marketing literature further suggests that the repositioning of existing brands offered as an alternative to entry may be virtually impossible in the real world. *See generally* Deven Desai & Spencer Weber Waller, *Brands, Competition and the Law*, 2010 B.Y.U. L. REV. xx (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1545893.

²⁵⁰ Stucke, *Behavioral Economists*, *supra* note 239, at 563-72.

²⁵¹ Edward B. Rock, *Antitrust and the Market for Corporate Control*, 77 CAL. L. REV. 1365 (1989).

also suggests limiting growing antitrust immunities in the securities law field and an ill-advised over-deference and reliance of the courts on securities regulators to maintain competition in order to maximize shareholder value in the takeover process.²⁵²

If management cannot document convincingly why a particular new contemplated transaction of the type that typically has harmed shareholders in the past is different than its predecessor, then the board should have the duty to reject the deal as against the interests of shareholders. If it fails to do so, the board should be held liable, not because the transaction turned out badly, but because the board ignored the red flags of the past and failed in its duty to adequately probe the new transaction in advance. Similarly, if the principal reason that a transaction may enhance shareholder value is the likely increased exercise of market power, rather than dubious efficiency scenarios which typically have not panned out in the past, then the board must similarly do more before the transaction meets with their approval.

Broader changes could do much to better align the incentives of corporate boards to enter into mergers and acquisitions that both increase shareholder value and do not violate the antitrust laws and refrain from transactions that violate either or both legal regimes. Some commentators have proposed addressing this issue by amending the Clayton Act itself to shift the burden of proof and persuasion to the parties to a transaction to demonstrate the pro-competitive and efficiency enhancing aspects of the deal in order to win approval.²⁵³ While this would certainly do the trick, such a wide ranging proposal raises serious issues beyond the unlikely chances of adoption by Congress. The most noticeable is that it uses antitrust as a club to indirectly achieve governance goals where the real problem is that the deal is value destroying for shareholders, not that it harms competition for the public.

²⁵² *Billing v. Credit Suisse First Boston, Ltd.*, 551 U.S. 264 (2007); *In re Elec. Trading Group, LLC v. Banc of Am. Securities, LLC*, 588 F.3d 128 (2d Cir. 2009).

²⁵³ Letter from Albert A. Foer, President, American Antitrust Institute, to Christine Varney, Ass't Att'y Gen. for Antitrust, U.S. Dep't of Justice, *available at* http://www.antitrustinstitute.org/archives/files/Clayton%20A%203-29-10%20Letter_033120101343.pdf; AMERICAN ANTITRUST INSTITUTE, *TRANSITION REPORT ON COMPETITION POLICY* 387 (2008), *available at* http://www.antitrustinstitute.org/archives/files/Summary%20of%20Major%20Recommendations%20from%20AAI%20Transition%20Report_100520082048.pdf.

More nuanced proposals on the corporate governance have included increased disclosure to the SEC and shareholders of efficiency claims when such claims are the basis for proceeding with the kind of stock for stock mega-deals that have proved so destructive of shareholder value in the past.²⁵⁴ To avoid pro-forma disclosure that does nothing to avoid deter such transactions, post-transaction reporting could be required to document where efficiencies and synergies have been realized and where such benefits have failed to materialize.²⁵⁵

The increased scrutiny for dubious value destroying deals should be on both the antitrust and corporate governance side. There should be increased skepticism of these same types of transactions by the antitrust agencies and courts in addition to increased duties by corporate boards and disclosure to the securities agencies. Antitrust and securities agencies should work hand-in-hand so that parties to mergers and acquisitions are providing consistent, truthful, and credible information to both sets of agencies just as the antitrust agencies currently do with their US sectoral regulators and their foreign counterparts. If efficiency claims are weak, then parties have a more serious burden on the corporate governance side in explaining why the transaction enhances shareholder value. And if the efficiency claims are weak, but the parties are claiming that the transaction nonetheless enhances shareholder value, then they have some antitrust explaining to do. But they cannot have it both ways, or even worse proceed with transactions that fly in the face of the values promoted by both field of law, potentially harming both shareholders and consumers in the process.

F. Abuse of Dominance

Liability for abuse of dominance or monopolization is much more nuanced, almost never condemned without highly intensive inquiry into facts and economics effects, and less subject to international consensus as to theories of liability or remedy. Such cases tend to be fewer and far between but much higher stakes as

²⁵⁴ Stucke, *Behavioral Economics*, *supra* note 239, at 582.

²⁵⁵ Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 222-27 (1992)(proposing conditional clearance of mergers subject to post-closing verification of efficiencies).

illustrated by the Microsoft litigation in the United States,²⁵⁶ the European Union,²⁵⁷ and elsewhere around the world.²⁵⁸ In almost every jurisdiction, such investigations and cases begin with an examination of whether the firm in question has market power which is frequently dependant on difficult questions of market definition. If significant market power is found, then the case then typically turns on very specific analysis of corporate behavior involving pricing, contracting practices, innovation programs, product design, and other questions of corporate strategy. Standards for unlawful monopolization or abuse of a dominant position differ greatly between jurisdictions.²⁵⁹

In the United States, liability increasingly turns on whether the anticompetitive harm outweighs the precompetitive benefits and efficiencies generated by the very same conduct at issue. In modern times, penalties generally are behavioral, rather than structural.²⁶⁰ Criminal enforcement is theoretically possible but has not been used since the late 1960s and appears to be abandoned as a realistic option.²⁶¹

There are very few cases that deal with what should constitute the appropriate red flags in connection with potential liability for monopolization or abuse of dominance. One of the few recent examples arose not surprisingly for the Intel Corp. which recently faced a series of competition law investigations and cases throughout the world.²⁶²

²⁵⁶ United States v. Microsoft Corp., 56 F.3d 1448 (D.C. Cir. 1995).

²⁵⁷ Case T-201/04, Microsoft Corp. v. Comm'n, 2007 E.C.R. II-3601 (Ct. First Instance).

²⁵⁸ See Abbott B. Lipsky, Jr., *Managing Antitrust Compliance Through the Continuing Surge in Global Enforcement*, 75 ANTITRUST L.J. 965, 983 n. 51 (2009)(describing proceedings against Microsoft throughout the world).

²⁵⁹ Michal S. Gal, Avishalom Tor & Spencer Weber Waller, *Expansion and Contraction in Monopolization Law*, 76 ANTITRUST L.J. 653 (2010).

²⁶⁰ Spencer Weber Waller, *The Past, Present, and Future of Monopolization Remedies*, 76 Antitrust L.J. 11 (2009).

²⁶¹ The last known criminal case under Section 2 appears to be from 1967. United States v. Union Camp Corp., Cr. Action No. 4558 (E.D. Va. Filed Nov. 20, 1967)(indictment on file with author).

²⁶² Intel Corp., FTC Dkt. No. 9341, Complaint and Proposed Consent Decree available at <http://www.ftc.gov/os/adipro/d9341/index.shtml>; In re Intel, COMP/C-3/37.990, [2010] 4 C.M.L.R. 5 (May 13, 2009)(imposing fine equivalent to over 1 billion euros for abuse of dominant position in EU).

A shareholder derivative action alleged the board's failure to prevent Intel from unlawfully monopolizing the market for computer microprocessors.²⁶³ The board of directors was ultimately successful because of the failure of the plaintiffs' to plead particular facts demonstrating that the board had "actual or constructive knowledge" of the wrongdoing such that a failure to respond to the alleged red flags resulted in a breach of their fiduciary duties to properly monitor corporate compliance.²⁶⁴

The court noted that the plaintiffs did "little more than catalog the ongoing investigations into Intel's wrongdoing" as an attempt to show that by virtue of the existence of numerous red flags, the directors faced "substantial likelihood" of personal liability.²⁶⁵ In other instances, the court found that some of the more specific allegations of red flags at the time of the decision were premature, and thus not grounds for liability. This included an investigation by the European Commission that the court characterized as preliminary.²⁶⁶

In contrast, the court noted that the Japan Fair Trade Commission's investigation and report on the anti-competitive activities of an Intel subsidiary in Japan could constitute a red flag.²⁶⁷ However the fact that the board complied with the JFTC report showed that it had, in fact, responded to the red flag. Additionally the plaintiff pointed to investigations by the Korean Fair Trade Commission and the New York Attorney General as constituting sufficient red flags.²⁶⁸ However, the court held that the plaintiffs had failed to adequately allege that the individual directors either knew or should have known about the illegal anticompetitive activities.²⁶⁹

²⁶³ *In re Intel Deriv. Litig.*, 621 F. Supp. 2d 165 (D. Del. 2009).

²⁶⁴ *Id.* at 174.

²⁶⁵ *Id.*

²⁶⁶ *Id.* at 170.

²⁶⁷ *Id.* at 176.

²⁶⁸ *Id.* at 175.

²⁶⁹ Since the court's decision, the EU has fined Intel in excess of \$1 billion and the Federal Trade Commission has brought and settled a case against Intel for violating Section 5 of the Federal Trade Commission Act which prohibits "unfair methods of competition." See FTC Press Release, Dec. 16, 2009, FTC Challenges Intel's Dominance of Worldwide Microprocessor Markets, available at <http://www.ftc.gov/opa/2009/12/intel.shtm>; FTC Press Release, *FTC Settles Charges of Anticompetitive Conduct Against Intel*, available at <http://www.ftc.gov/opa/2010/08/intel.shtm>; EU Press Release, IP/09/745, May 13, 2009, Antitrust: Commission imposes fine of €1.06 bn on Intel for abuse of

Intel thus suggests that there is no reason to think board can micro-manage each decision of firm with market power, although the need for monitoring systems seems appropriate once market power is achieved or becomes a serious risk. However, there are also areas of legitimate concern for dominant firms (like any other corporate entity) where board involvement is more traditional. These can include acquisition of fringe and potential rivals, patterns of deception, broadly exclusionary conduct at the strategic level, rather than operational, level. In short, these will be some areas where the business judgment rule does, and ought to, have some bite in terms of director involvement and ultimate liability as others where it should not suffice as a shield.²⁷⁰ For example, the UK's statute and guidelines on director disqualification for competition violations state that the competition authority will take into account any genuine uncertainty over the legality of the conduct.²⁷¹ One commentator expressed the hope that this would particularly be the case for abuse of dominance cases where "the boundaries between competing 'on the merits' and illegal conduct can be particularly opaque."²⁷²

V. Conclusion

Better understanding the ties between corporate governance and competition law should lead to important legal and policy changes. Looking at the fields for their intersections, rather than their differences, opens up potential avenues for change on both sides of the existing fence.

For directors, clear rules are better than complicated highly fact specific inquiries where after the fact second guessing may expose the directors to potential liability. This is the basis for the business

dominant position; orders Intel to cease illegal practices, *available at* <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/745>.

²⁷⁰ In the modern era, it is hard to envision the active participation of the board of directors in the monopolization of an industry as appeared to be the case throughout the gilded era of the late 19th century. See e.g., RON CHERNOW, *TITAN* (1999)(biography of John D. Rockefeller detailing monopolization of oil refining and transportation industries).

²⁷¹ OFT Guidelines, *supra* note 186, at 13.

²⁷² WilmerHale, Regulatory Alert, *Let the Punishment Fit the Crime? UK's OFT Publishes Revised Guidance on Disqualifying Directors for Competition Law Infringements* (July 15, 2010), *available at* <https://extranet.wilmerhale.com/64/s1035/publications/whPubsDetail.aspx?publication=9563>.

judgment in the first place. While a director obviously prefers no liability to the possibility of some liability, at the same time “no” is often better than “maybe” when viewed *ex ante* rather than *ex post*. While the existing statutory rules barring interlocking directorates between competing corporations are by no means perfect, they are workable clear rules that most businesses have little difficulty complying with, even though this provision undoubtedly produces both false positives and false negatives from time to time.

Sometimes highly fact specific inquiries may be unavoidable. Clear-cut rules of when a board of directors must take action to prevent or report cartel activity do exist. However, they are few and far between and often limited to situations where it is already too late from the point of view of either good governance or good competition policy. Better incentives can be created for both good governance and effective compliance policies through individual director liability when reasonable steps are not taken to implement and monitor compliance programs which have a reasonable likelihood of deterring, detecting, and reporting hard-core activity. As the business judgment rule teaches us, reasonable judgments should be deferred to, but the failure to exercise judgment is not worthy of deference and director liability may be appropriate where the failure to act has harmed the corporation and its shareholders. Sub-optimal governance and decision making can be further promoted through statutory, judicial, or regulatory director disqualification where board members have been actively complicit or manifestly fallen down on the job. Even in the fuzzier area of rule of reason liability, good governance structures can be designed to minimize both conflicting incentives and anticompetitive consequences.

In the merger area, the corporate finance literature is convincing that mega-mergers on a stock for stock basis between roughly equal competitors are highly likely to destroy shareholder value. There are a number of resulting helpful steps in both corporate governance law as well as antitrust. On the corporate governance, the tendency of stock-for-stock mega-mergers among equals tend to be value destroying argues in favor of enhanced board duties in reviewing and approving such deals.²⁷³ It further suggests the need for enhanced securities disclosure to shareholders and regulators for such categories of value destroying deals or when parties to the transaction seek to rely

²⁷³ Fanto, *Braking the Merger Momentum*, *supra* note 227, at 251-57.

on efficiency claims.²⁷⁴ Securities and competition regulators equally must be more vigilant in scrutinizing such facile claims which rarely materialize in the real world. Finally, some intermediate standard of review is called for in the courts beside near blind deference to board approval under the current formulation of the business judgment rule.²⁷⁵

On the antitrust side, there needs to be increased attention to the type and categories of deals which prove to be value destroying and why. There needs to be a better understanding of why predicted synergies and efficiencies more often than not are not achieved. More importantly, there needs to be a better understanding of why certain deals may be value enhancing. If there are not substantial synergies and efficiency gains, when is increased market power a more likely explanation?

To be clear, mergers are not unlawful under the antitrust laws because they are stupid, or well-meaning but turn out badly. They only violate Section 7 of the Clayton Act where they have the tendency to substantially harm competition. However, the present situation is the worst of all possible worlds where certain types of mergers typically do nothing for shareholders nor for competition. Even worse, both bodies of law which purport to regulate such transactions have inadequate tools to help shareholders or competition in the market as a whole.

Although it is not phrased this way, there is at least a soft presumption in both corporate governance and antitrust that most mergers and acquisitions are efficient and should be regulated primarily by market forces. The Horizontal Merger Guidelines come closest to this in stating that the “primary benefit of mergers to the economy is their efficiency-enhancing potential.”²⁷⁶ The building empirical and theoretical evidence from the economic, finance, and accounting world as well as behavioral economics suggests this is not inevitably so.²⁷⁷

The key question is *ex ante* which type of mergers are likely to generate which types of efficiencies with what degree of probability

²⁷⁴ Stucke, *Behavioral Economists*, *supra* note 239, at 582; Amanda Reeves & Maurice Stucke, *Behavioral Antitrust*, *supra* note 223, at 55.

²⁷⁵ Fanto, *Braking the Merger Momentum*, *supra* note 227, at 263.

²⁷⁶ 2010 Horizontal Merger Guidelines, *supra* note 40, at § 10.

²⁷⁷ F.M. Scherer, *Some Principles for Post-Chicago Antitrust Analysis*, 52 CASE W. RES. L. REV. 5, 18 (2001).

and what degree of magnitude? To the extent that the economic, financial and corporate governance literature is persuasive that there are categories of mergers which are sufficiently value destroying and that the *ex ante* efficiency claims are strongly suspect then the agencies and the courts should be particularly suspect of such claims. As a result, any legal presumptions should run against such claims.

These collective blind spots cannot be remedied without both communities investing in increased attention to each other's literature, language, and expertise. For the antitrust community this means greater investment in business theory as a supplement to the already substantial economic expertise brought to bear on merger analysis. For the corporate governance community, this means increased attention to the role of competitive and anti-competitive outcomes in formulating duties and responsibilities for corporate actors. This suggests new possibilities of collaborative research and teaching across formerly separate law school subjects and between law school and business school faculty.

Antitrust lawyers and policy makers can also play a meaningful role in corporate governance as competition advocates. It is common practice for competition agencies, bar associations antitrust committees, specialty antitrust associations, practitioners, and academics to play an active role in competition advocacy more generally.²⁷⁸ This can be in the formulation of antitrust guidelines by federal, state and foreign agencies and/or formulation of policies and rules by sectoral regulators at the federal, state, and local levels. Such competition advocacy must be extended to related issues in corporate governance when government and private groups are formulating policies that seek to ameliorate (or worsen) the conflicting incentives and agency costs that lie at the heart of corporate governance. Only in such a world of deep interaction and continued inter-disciplinary learning will both shareholders and consumers benefit from efficient and shareholder oriented public corporations operating in a more consumer friendly competitive economy.

²⁷⁸ See generally D. Daniel Sokol, *Limiting Anticompetitive Government Interventions That Benefit Special Interests*, 17 GEO. MASON L. REV. 119 (2009); Maurice E. Stucke, *Better Competition Advocacy*, 82 ST. JOHN'S L. REV. 951, 957-59 (2008); James C. Cooper, Todd J. Zywicki & Paul A. Pautler, *Theory and Practice of Competition Advocacy at the FTC*, 72 ANTITRUST L.J. 1091 (2005).