THE FOLLOWER PHENOMENON: IMPLICATIONS FOR THE DESIGN OF MONOPOLIZATION RULES IN A GLOBAL ECONOMY

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I. INTRODUCTION

Antitrust laws have proliferated around the world: whereas three decades ago only two dozen jurisdictions or so had an antitrust law, current figures enumerate more than one hundred jurisdictions.[1] New antitrust rules are oftentimes modeled, at least in part, on those of jurisdictions with established antitrust regimes, especially those of the United States and the European Union, a trend we call "the follower phenomenon."[2]

The most visible type of follower behavior occurs when one jurisdiction transplants a foreign legal rule. Such a transplant might include the rule's substantive parts as well as its institutional parts. An additional type of follower conduct, which is

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[1] Hylton and Deng list 102 jurisdictions with antitrust regimes. Keith N. Hylton & Fei Deng, *Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects*, 74 ANTITRUST L.J. 271, 276, 326-31 tbl. A4 (2007). *See also* Keith N. Hylton et al., Antitrust World Reports, http://antitrustworldwiki.com (providing information on the competition laws of various countries).

[2] *See, e.g.,* Russell W. Pittman, *Competition Law in Central and Eastern Europe: Five Years Later*, 43 ANTITRUST BULL. 179, 179-80 (1998); Michael W. Nicholson, *An Antitrust Law Index for Empirical Analysis of International Competition Policy*, 4 J. COMP. L. & ECON. 1009, 1018-22 (2008) (comparing the antitrust laws on the books of fifty-two jurisdictions using an antitrust index of prohibitions and regulatory tools).

less visible and is not necessarily cumulative to the first type, involves the transplant of the interpretation of a legal rule.[3] Whereas the first type is a one-time event, the second is often an on-going one.

Both types are quite common. The first type can be exemplified by the merger regulation adopted by most jurisdictions, which follows the ex ante notification and authorization regulatory model first applied in the United States.[4] The second type is exemplified by the interpretation given to "agreement" by all jurisdictions, which excludes oligopolistic coordination.[5] This interpretation was first adopted by the United States and generated a famous scholarly debate.[6] Indeed, comparisons of antitrust laws often exemplify the relatively high degree of similarity among them, alongside the differences that exist.[7]

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[3] Of course, once a similar rule is adopted, there is a stronger tendency to follow its interpretation.

[4] Hart-Scott-Rodino Antitrust Improvements Act 1976, Pub. L. No. 94-435, 90 Stat. 1383 (1976).

[5] *See, e.g.* ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT Committee on Competition Law and Policy, Policy Roundtables: OLIGOPOLY 7-8 (1999), *available at* http://www.oecd.org/dataoecd/35/34/1920526.pdf (stating that the competition laws of OECD countries generally do not permit courts to infer that firms have reached an illegal "agreement" based purely on "oligopolistic interdependence"); SIGRID STROUX, US AND EC OLIGOPOLY CONTROL, chs. 1 & 4 (2004) (explaining that oligopolistic coordination does not, without more, violate either Section 1 of the Sherman Act or Article 81 of the EC Treaty).

[6] *Compare* Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal,* 75 HARV. L. REV. 655 (1962) (arguing that the Sherman Act's prohibition of agreements in restraint of trade should not cover oligopolistic coordination) *with* Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562 (1969) (arguing that oligopolistic coordination should be actionable under the Sherman Act).

[7] Compare, for example, the descriptions of various features of many of the national merger notification systems, based on data compiled by members of the International Bar Association and other sources and reported in Int'l Bar Ass'n, Jurisdictional Matrix of Merger Laws (2002), *available at* http://www.internationalcompetitionnetwork.org/uploads/library/doc487.pdf.

Both types of the follower phenomenon may be partial or complete. Moreover, the following of a certain prohibition may be complete with regard to one type and partial with regard to another. Furthermore, one jurisdiction may be followed with regard to the content of a rule and another with regard to its interpretation, given that all antitrust laws have a core similarity.[8]

The follower phenomenon, especially its first type, may result from external pressures of foreign jurisdictions or international institutions. The European Union, for example, requires in its trade agreements some level of similarity in the application of antitrust laws.[9] But often the follower conduct is voluntary or quasi-voluntary, sometimes based on strategic considerations. For example, even before its accession to the European Union, the Maltese Competition Act directed Maltese courts to follow EU case law in interpreting it.[10] The tendency to follow the laws of another jurisdiction varies among jurisdictions. Some jurisdictions -most notably small or developing or inexperienced ones–have strong motivations to follow the laws of large, established jurisdictions given their inexperience or limited resources for

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[8] This is exemplified by the Israeli monopolization prohibition, which is a legal transplant of Article 82 of the EU Treaty of Rome. Israeli Restrictive Trade Practices Act 1988, §29A. *See* Michal S. Gal, *The 'Cut and Paste' of Article 82 of the EU Treaty in Israel: Conditions for a Successful Transplant,* 9 EUR. J. L. REFORM 467 (2007). In applying the provision in practice, however, Israeli courts oftentimes base their decisions on U.S. case law and commentary. *See, e.g.* the Israeli cases of M1/93 *Director of Competition Authority v. Dubek Inc. et al. in* Kovetz Psika, vol. b, 194; M2/96 *Director of Competition Authority v. Yediot Aharonot Inc. et al.* (Israeli Competition Tribunal, unpublished, 7 June 2000), English translation *available at* http://eng-archive.antitrust.gov.il/ANTItem.aspx?ID=67.

[9] *See, e.g.,* Euro-Mediterranean Agreement establishing an Association between the European Communities and their Member States, of the one part, and the State of Israel, of the other part, O.J. L 147/3 (2000), art. 36. A similar requirement was included in the Free Trade Agreement between EFTA and Israel in 1992; The Agreement on the European Economic Area, (1994) O.J. L 1/3, Articles 53 to 64.

[10] Maltese Competition Act 1994, Schedule, §13. This transplantation might have been affected by the wish to join the European Union.

defining optimal rules, although, as elaborated below, the strength of such motivations varies among such jurisdictions.[11] Follower conduct may also take place among large, established jurisdictions. Such behavior is based, however, on different motivations, such as the wish to base the analysis on a similar foundation---such as economic analysis---which was first applied elsewhere.[12]

This is not to say that jurisdictions always follow the antitrust laws of others. Rather, they sometimes adopt different regulatory models that are based on divergent goals or diverse perceptions of the role of the state in regulating markets. For example, a focus on fairness, which is included in the EU Treaty of Rome, reflects the perceived objectives of the law, which are not limited to economic efficiency.[13] Likewise, the Canadian focus on total welfare in its merger analysis, which differs from the consumer welfare test adopted by most other jurisdictions, reflects a unique perception of the best way to maximize social welfare.[14] Moreover, even the application of similar laws may vary widely, depending, inter alia, on the procedural and evidentiary rules applied, the quality of the decision making process, the clarity of the rule, the goals and objectives of the law and the decision makers, and the

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[11] For a discussion of the costs and benefits to small economies of following the laws of large ones *see, e.g.,* Gal, *supra* note 8, at 474-81.

[12] *See generally* Christian Ahlborn & Jorge Padilla, *From Fairness to Welfare: Implications for the Assessment of Unilateral Conduct Under EC Competition Law*, *in* EUROPEAN COMPETITION Law ANNUAL 2007 (M. Marquis & C-D. Ehlermann eds., 2008) 55, 62.

[13] *See, e.g.,* DAVID J. GERBER, LAW AND COMPETITION IN TWENTIETH CENTURY EUROPE: PROTECTING PROMETHEUS (1998), at 1-2.

[14] Competition Act, R.S.C. 1985, c. C-34, §96, *available at* http://laws.justice.gc.ca/PDF/Statute/C/C-34.pdf. *See also* Competition Bureau of Canada, Merger Enforcement Guidelines, 37-38 (2004), *available at* http://www.bureaudelaconcurrence.gc.ca/eic/site/cb-bc.nsf/vwapj/2004%20MEGs.Final.pdf/$file/2004%20MEGs.Final.pdf.

preferences of the decision makers for some economic or socio-economic theories or methodological tools. This is exemplified by emphasis placed by the EU on the uniformity of interpretation of Articles 81 and 82, and of their relatively similar national antitrust laws, by the Member States' courts.[15] Indeed, a unified antitrust law is unrealistic. Nonetheless, the follower phenomenon is often observed in antitrust.[16]

In what follows, we analyze the main causes of the follower phenomenon and its welfare effects. First we analyze these issues from the point of view of the following jurisdiction. Next we analyze the motivations and effects on the followed jurisdiction. While many commentators have recognized the possible welfare-reducing effects on the *following* jurisdiction, they generally disregard the effects on the *followed* jurisdiction.[17] This article attempts to fill this void. It argues that the proliferation of one's antitrust prohibitions can sometimes act as a boomerang, negatively affecting the welfare of the followed jurisdiction as well as third jurisdictions.

As explained in greater detail below, this boomerang effect can result from three main causes: (a) the limited ability of the followed jurisdiction's or other exporting jurisdictions' domestic firms to monopolize or cartelize foreign markets due

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[15] *See*, *e.g.,* European Commission, The White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty, Commission Programme No 99/027, ¶¶ 82-107 (1999), *available at* http://europa.eu/documents/comm/white_papers/pdf/com99_101_fr.pdf (describing measures to ensure the uniform interpretation of EU competition law by national courts).

[16] For some specific examples of such conduct, see, for example, sources in notes 2, 5 and 7.

[17] *See, e.g.,* Alan Watson, *Aspects of Reception of Law*, 44 AM. J. COMP. L. 335 (1996); Willliam Ewald, *Comparative Jurisprudence (II): The Logic of Legal Transplants*, 43 AM. J. COMP. L. 489 (1995); H. Kanda & C. Milhaupt, *Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law*, 51 AM. J. COMP. L. 887(2003).

to stricter antitrust policies of the following jurisdiction based on a correct following of the followed jurisdiction's antitrust prohibitions;[18] (b) the abandonment of neutral or procompetitive conduct by firms based in the followed jurisdiction (or trading in it) due, for example, to increased costs resulting from parallel and often similar regulation in several following jurisdictions; and (c) negative externalities resulting from increased error costs due, for example, to the misapplication of the followed jurisdiction's complex rules in following jurisdictions with limited institutional capabilities.

Based on the above findings, we then propose ways for the followed jurisdiction, as well as for other jurisdictions to increase the positive externalities and limit the negative externalities resulting from the follower phenomenon. We suggest that under certain circumstances the following jurisdiction could anticipate the follower phenomenon and modify its choice of optimal rule to account for the boomerang effect. Less extreme methods that can increase the welfare of the followed, the following, and other jurisdictions are also explored, such as aiding and directing less experienced jurisdictions in the correct application of their antitrust laws.

The follower phenomenon and the externalities it might create are exemplified by the antitrust treatment of unilateral conduct. This serves as a good example, since the EU abuse of dominance prohibition is one of the most followed antitrust prohibitions internationally. Indeed, at least forty-three jurisdictions have copied this

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[18] This result comports with Guzman's seminal work on international antitrust, particularly his assessment of how a nation's status as a net importer or net exporter affects its preferences regarding the applicable antitrust standards in foreign jurisdictions which affects their exporters. Andrew T. Guzman, *Antitrust and International Regulatory Federalism*, 76 N.Y.U.L. REV. 1142, 1151-56 (2001); Andrew T. Guzman, *Is International Antitrust Possible?*, 73 N.Y.U.L. REV. 1501, 1510-24 (1998).

prohibition into their laws.[19] Moreover, abuse of dominance prohibitions are often articulated as broad and unclear standards, the implementation of which often involves relatively complex economic and legal analysis.[20] The application of such broad standards carries the potential to create significant error costs, especially when applied in jurisdictions with low institutional capacity.

II. THE FOLLOWER PHENOMENON: EFFECTS ON THE FOLLOWER JURISDICTION

A major key for understanding the dynamics of the follower phenomenon involves the circumstances that motivate one jurisdiction to follow the laws of another.[21] In this part, we provide a broad brush analysis given that this issue was explored in detail elsewhere.[22] The analysis is based on the assumption that the followed law is, indeed, applied in practice and has some effects on competition policy.

A. POSITIVE EFFECTS ON THE FOLLOWING JURISDICTION

[19] Many jurisdictions have transplanted §82 of the Treaty Establishing the European Community (consolidated text), art. 82, Dec. 29, 2006, 2006 O.J. (321E) 37. A review by the authors reveals that these include, inter alia, the 27 EU Member States, Bosnia-Herzegovina, Croatia, Greenland, Iceland, Israel, Norway, Serbia-Montenegro and Namibia. Eight additional jurisdictions followed the EU provisions with minor changes: Albania, Armenia, Jersey, Macedonia, Mauritius, Singapore, Uruguay, Venezuela. *See, e.g.,* Keith N. Hylton et al., *supra* note 1 (which includes references to the text of the antitrust laws of most jurisdictions). Many of the following jurisdictions are European. This fact might even strengthen the need to acknowledge and deal effectively with the effects of the follower phenomenon, given the generally strong trade ties and thus the externalities among European jurisdictions.

[20] *See, e.g.,* Einer R. Elhauge, *Defining Better Monopolization Standards* 56 STAN. L. REV. 253 (2003); David S. Evans & Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73 (2005).

[22] This part is mainly based on Gal, *supra* note 8, at 471-74.

Countries differ in their socio-economic objectives as well as their market conditions. Thus, different laws might sometimes best serve such objectives.[23] Nonetheless, jurisdictions often transplant the antitrust laws of other jurisdictions, at least to some degree.[24] Put more picturesquely, the realm of antitrust is not an autarky in which each jurisdiction grows its own legal innovations. Rather, antitrust law is often based on the experience of other countries. Jurisdictions can have strong motivations to follow another's antitrust laws, even if the imported law does not completely match domestic conditions. Different jurisdictions might have different motivations for following another's law.[25] In particular, these motivations are generally stronger the smaller the jurisdiction (and thus the more limited its financial enforcement resources), the less developed it is (and thus the more limited its human and often also its financial enforcement resources),[26] and the greater the perceived success of the regulatory model in the followed jurisdiction. Yet the strength of such motivations may differ even among such jurisdictions. Large, emerging jurisdictions, such as China, often have weaker motivations to follow the laws of others rather than shape their laws to their special characteristics, relative to other developing jurisdictions. Such weaker motivations may result, inter alia, from the larger size of resources (both human and financial) that can be spent in such jurisdictions on developing their own laws, from their lower dependence on trade with other

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[23] For a discussion of the effect of market size on optimal rules see MICHAL S. GAL, COMPETITION POLICY IN SMALL MARKET ECONOMIES (2003).

[24] For some specific examples of such transplants, see, for example, notes 5, 7 and 19 *supra*.

[25] *See generally* Ahlborn & Padilla, *supra* note 12, at 5-7 (examining various objectives that countries might pursue through competition laws).

[26] *See, e.g.,* Michal S. Gal, *When the Going Gets Tight: Institutional Solutions When Antitrust Enforcement Solutions Are Scarce* 41 LOY. U. CHI. L. J. (forthcoming 2009).

jurisdictions, or from the uniqueness of their socio-economic or normative characteristics relative to other jurisdictions. The analysis below elaborates on the effects of such considerations on the motivation to follow another's laws.

Adoption of "ready made" and pretested rules saves the costs of determining what content ought to be given to the law. With regard to monopolization, it might be believed that Article 82 of the EU Treaty is especially fit to serve this purpose since it includes, besides a general prohibition on abuse, a list of specific types of conduct which are considered to be abusive.[27] This list can provide some guidance as to the legality of certain types of conduct engaged in by a monopolist.[28]

Moreover, and oftentimes even more importantly, benefits flow from the transplanted law's application in its home jurisdiction: an established antitrust law has a long history of implementation, interpretation, and academic discourse in its saddlebag.[29] Foreign courts, enforcement agencies and market players can thus tap such resources to understand the transplant's concepts and how it should be applied in practice. Such benefits may not be limited to the time of the transplant. Rather, the continued application of the living law in a generally well-functioning jurisdiction generates positive network externalities: as more decisions and guidelines that apply the law to various factual settings accumulate, legal certainty is typically increased. Such benefits are especially important with regard to the competitive assessment of

[27] For a list of jurisdictions which have transplanted Article 82 into their laws s*ee* footnote 16 *supra*.

[28] For suggestions that greater guidance is needed in determining how to apply article 82 to particular conduct, see, for example, Jim Venit, *Article 82: The Last Frontier -- Fighting Fire with Fire*, 28 FORDHAM INT'L L.J. 1157 (2005); Damien Geradin, *Limiting the Scope of Article 82 EC: What Can the EU Learn from the U.S. Supreme Court's Judgment in* Trinko *in the Wake of* Microsoft*,* IMS*, and* Deutsche Telekom 41 Common Mkt. L. Rev. 1591 (2004).

[29] *See, e.g.,* Gal, *supra* note 8, at 476.

unilateral conduct, which is based on generally elastic and open-ended notions, often applied on a case-by-case basis and more prone to changes based on new economic teachings. The importance of this effect is apparent when one compares it to the alternative: the internal creation of such resources by domestic enforcement bodies and academia. Such a process might be lengthy and costly.

The transplant can also help push through new concepts and ease their acceptance.[30] The adoption of a foreign law that is perceived to be successful can help convince local constituencies of its importance. In addition, such adoption can assist the government in combating group-specific political pressures by providing needed legal authority to push forward new ideas and concepts.[31]

These benefits have a common trait: they are all inward looking and would exist even if the following and followed jurisdictions had no trade relationships. Additional benefits arise when we add trade to the analysis. Some large jurisdictions require that their trading partners prohibit anticompetitive conduct to prevent the creation of artificial barriers to entry.[32] Following their laws ensures at least some degree of compliance with this requirement.

Another important benefit from following the law of a large trading party is a reduction in the learning and compliance costs of firms wishing to trade beyond their

[30] Watson, *supra* note 17, at 350-1.

[31] In some cases, however, the choice between different transplants can become a political struggle itself. The recommended practices adopted by the ICN have, to some extent, eased the adoption of changes in the antitrust laws of some jurisdictions, to be more in line with such recommendations. "At least thirty-five ICN members, which is approximately half of all members with a merger notification system, have amended their laws, regulations, or procedures, bringing them into closer conformity with the ICN recommendations." Eleanor M. Fox, *Linked-In: Antitrust and the Virtues of a Virtual Network* 43 INT'L LAW. 151, 164-65 (2009).

[32] *See, e.g.,* Euro-Mediterranean Agreement, *supra* note 9, Article 36. The Agreement of the European Economic Area, *supra* note 9, Articles 53 to 64.

jurisdiction which, in turn, serves to create a more competitive environment.[33] Legal transplants reduce the costs for domestic exporters of learning which antitrust issues they might face in the followed jurisdiction. In addition, they may strengthen procompetitive pressures in the domestic market by increasing the incentives of foreign firms to import into the follower's market, given the lowered costs of learning about its antitrust law framework, all else equal.[34] Moreover, unification of legal rules may ease the creation of procompetitive multinational joint ventures. Finally, it might better enable antitrust authorities to work together towards joint solutions to cross-border competition issues.

Accordingly, an antitrust transplant may be highly beneficial for the following jurisdiction. Such benefits are dependent, of course, on the transplanted law not being unduly burdensome and not significantly diverging from one's otherwise optimum law.

B. NEGATIVE EFFECTS ON THE FOLLOWING JURISDICTION

Not all the effects of an antitrust transplant are positive, however. Even if the law is optimal for the followed jurisdiction, this does not guarantee that it will be beneficial for the potential following jurisdiction. Most importantly, legal transplants can be unsuccessful and even harmful if they do not deal effectively with the special characteristics of the following jurisdiction. Such characteristics include cultural traits and economic or sociological conditions and objectives which affect the law.[35] For

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[33] *See, e.g.,* GAL, *supra* note 23, at 10, 259.

[34] Of course, the content of the domestic law is also an important parameter. The stricter the law generally the higher the entry barriers it creates.

[35] The effect of cultural traits on the ability to transplant a law has generated a heated debate. *See, e.g.,* CHARLES LOUIS DE SECONDAT MONTESQUIEU, THE SPIRIT OF LAWS (David Wallace Carrithers ed. 1977) (1748); FRIEDRICH CARL VON SAVIGNY, ON THE VOCATION OF OUR AGE FOR LEGISLATION AND JURISPRUDENCE (Abraham Hayward

example, a prohibition against high monopolistic prices will clash with the economic beliefs of a jurisdiction in which monopolistic profits are regarded as the fruits of success in the market game.[36] Furthermore, the foreign law might clash with other elements of local law. Jamaica serves as such an example: the fact that its antitrust authority was given a double role as both investigator and prosecutor of antitrust offences, like the role of the U.S. Federal Trade Commission, was ruled to be unconstitutional and led to a long period in which the authority could not engage in investigations.[37]

But there might be a more subtle cost in following foreign law: given diverse enforcement conditions, similar laws might be applied differently in different jurisdictions. Laws which may promote efficiency under certain institutional conditions might instead generate high error costs under inferior institutional conditions that would, in turn, reduce domestic welfare.[38] Relevant institutional conditions include, inter alia, the level of economic analysis that can be performed at all levels of the decision making process, the legal and practical tools at the decision

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trans., 1999) (1814); Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect*, AM. J. COMP. L. 163 (2003).

[36] High monopolistic prices are prohibited, for example, in the European Union, at least in theory. *See, e.g.,* O'DONOGHUE & A. JORGE PADILLA, THE LAW AND ECONOMICS OF ARTICLE 82 EC (2006), ch. 12. The United States views such prices as an important catalyst for competition. *See, e.g.*, Verizon Communc'ns, Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 407-08 (2004).

[37] The Jamaica Stock Exchange v. The Fair Trading Commission (Court of Appeal Civil Appeal No. 92/97, January 29, 2001).

[38] In a study of 18 Eastern European countries that are newcomers to antitrust Dutz and Vagliasindi found that the "institutional effectiveness" variable (measuring the competition regimes' political independence, transparency, etc.) showed the strongest impact on domestic competition of the competition policy variables. Mark A. Dutz & Maria Vagliasindi, *Competition Policy Implementation in Transition Economies: An Empirical Assessment*, 44 EUR. ECON. REV. 762, 770 (2000).

maker's disposal to gather the relevant information, the legal weight given to a decision by an expert decision maker, and political influences on the decision maker. These decision-theoretic and practical considerations shed light on potential error costs resulting from the misapplication of antitrust laws.

The error costs involved in the misapplication of a transplanted rule are often the result of the jurisdiction's limited ability to perform a complex economic analysis due to constraints on their human or financial resources.[39] Consider, for example, the prohibition of high monopolistic prices. Even if we assume that such a prohibition is justified in theory, if the level at which a price becomes excessive cannot be easily defined and requires complex economic analysis, then the error costs involved in establishing such a price can be extremely high. This is because a broad prohibition would create disincentives for firms to make investments that would enable them to win the market game.[40]

One may justifiably ask why jurisdictions follow rules that do not serve their own welfare. Indeed, some jurisdictions attempted to reduce this problem by adopting broad safe harbors or simplifying assumptions.[41] Such rules may better serve domestic welfare when increased error costs resulting from institutional shortcomings are

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[39] *See, e.g.,* William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI-KENT L. REV. 265, 270-73, 289, 305-08 (2001).

[40] *See* David S. Evans & A. Jorge Padilla, *Excessive Prices: Using Economics to Define Administrable Legal Rules*, 1 J. COMP. L. & ECON. 97 (2005).

[41] Some jurisdictions, for example, base a finding of monopoly power on high market shares. *See, e.g.,* Israeli Restrictive Trade Practices Act 1988, §26, *available at* http://www.antitrust.gov.il/Files/HPLinks/RTP%20Law.pdf; Croatian Competition Act 2003, §15(3), *available at* http://www.aztn.hr/eng/pdf/zakon/zztn.pdf. Croatia has a new Competition Act, effective October 2010. The new Act does not yet appear on the Competition Authority's website.

considered, although they also carry their own error costs.[42] Yet, as explained above, other considerations may pull in a different direction. These include the fact that designing rules for one's jurisdiction may be costly, that the jurisdiction may be subject to pressures from other jurisdictions to harmonize its laws with their own, and that the follower may not be aware of the increased error costs resulting from its institutional limitations.

III. THE FOLLOWER PHENOMENON: EFFECTS ON THE FOLLOWED JURISDICTION

Hitherto, we have focused on the motivations for and the effects of the follower phenomenon on the welfare of the following jurisdiction. Below we turn our attention to its effects on the followed jurisdiction, which are often absent from the analysis of legal transplants. Most importantly, we show that the follower phenomenon can sometimes harm the welfare of the followed jurisdiction.

We proceed in three steps. First, we identify and explain the effects that application of antitrust prohibitions in one jurisdiction may have on the *domestic* markets of other jurisdictions: the access effect and conduct effect. The analysis is general, and applies regardless of whether the foreign law follows the law of another jurisdiction. Second, we add the follower conduct to the analysis and consider the two effects in the context of following behavior. Finally, in the appendix, we develop a simple formal model to illustrate these effects and their welfare implications. These

[42] John Fingleton, Chairman of the UK OFT and the new chairman of the ICN, acknowledged that given different jurisdictions' institutional capabilities, we should aim at "convergence and informed divergence." *See* David Vascott, *ABA Debates Antitrust in a Downturn*, Global Comp. Rev., March 27, 2009, *available at* www.globalcompetitionreview.com/news/article/13147/aba-debates-antitrust-downturn (last visited Jan. 25, 2010). He also stated that not all jurisdictions have the ability to perform complex economic analysis, and in such situations it might be useful to use presumptions on dominant behavior. *Id.*

effects serve as good examples of the way that globalization has led to the loss of some national governance capacity.

A. THE ACCESS AND CONDUCT EFFECTS

Why do jurisdictions care about the monopolization regimes of others? The application of antitrust prohibitions in one jurisdiction (jurisdiction B) may affect welfare in another jurisdiction (jurisdiction A) in two main ways.

Antitrust prohibitions in a foreign jurisdiction B may affect the ability or the motivation of firms based in jurisdiction A to enter and expand in the foreign market (the "access effect"). This effect concerns the *profits* of domestic firms based in jurisdiction A resulting from trade in jurisdiction B and is independent of whether their profitability results from legitimate comparative advantages or from the monopolization or cartelization of foreign markets. For example, if jurisdiction B does not prohibit monopolization, then jurisdiction A might enjoy positive access effects if exporters from jurisdiction A use monopolization tactics to access and profit from the foreign market. However, the alternative is also possible. Exporters based in jurisdiction A might find it more difficult to enter or expand in jurisdiction B if monopolization by incumbents or by other entrants is not prohibited. An access effect can also arise when jurisdiction B applies antitrust prohibitions, as such application might affect the ability of jurisdiction A's firms to enter and expand in B.

Prohibitions in jurisdiction B may also affect the conduct of international firms in some or all the markets in which they trade (the "conduct effect") and not just in jurisdiction B. This, in turn, may affect consumer welfare in all those markets. The conduct effect is generally not intended by jurisdiction B and is an externality of its antitrust policy, although it can sometimes be anticipated by its policy makers.

The basic condition for the conduct effect is the existence of linkages among the activities of an international firm in the various jurisdictions. In such situations, a prohibition in one jurisdiction may create positive or negative externalities affecting consumers and producers of other countries. These linkages are generally, though not exclusively, economic and will most often affect international firms operating in two or more jurisdictions and thus subject to independent regulatory regimes.

One example involves foreign prohibitions that reduce the profitability of an international firm in a foreign market and impact the commercial behavior of that firm in other markets in which it operates. To illustrate, an international firm may reduce its investment on the development of a new product if the return on investment is capped by antitrust interventions in large markets (e.g., measures against excessive pricing).

A second example of economic linkages is given by a situation in which an international firm produces and sells similar quality products worldwide (or at least in part of the international market). It may do so because it is too costly to produce, design, or market differentiated products in different jurisdictions due to scale economies. It may also result from network effects, the realization of which requires that consumers use similar products. A prohibition in one jurisdiction which prevents the firm from engaging in conduct (e.g., technological integration) that would directly increase the quality of its products might thus harm consumers elsewhere. This will occur only when the jurisdiction prohibiting the conduct is sufficiently large that it would not be profitable for the international firm to simply exit it and only sell its products elsewhere. This condition may be met cumulatively: the parallel application of a similar prohibition in several jurisdictions may increase the loss from exiting such markets and create veto power. That is, their combined markets might create sufficiently strong incentives for the international firm to change its conduct rather than exit such markets.

Another example involves scale economies at a global level, where increased production reduces the unit costs of global production. Foreign antitrust laws that prohibit an international firm from engaging in conduct that would have allowed it to expand production and enjoy scale economies (in production, marketing or research and development) might create negative externalities. Realization of such economies would have reduced the firm's costs, which may have led to reduced prices for consumers elsewhere.[43] Conversely, foreign antitrust intervention against monopolization may reduce obstacles faced by an efficient international firm to expand and reach better scale economies, thereby benefiting consumers everywhere.

An additional result of the conduct effect in all the examples above is the reduced ability of the international firm to create sufficient competitive constraints in its domestic markets. This, in turn, may enable other firms operating in that market to raise prices, reduce quantity, or lower quality, thereby further affecting the welfare of the domestic market. Thus, we identify direct conduct effects that result from changes in the conduct of the regulated firm, and indirect conduct effects that result from changes in the conduct of other firms.

Interestingly, the conduct effect may even indirectly affect the behavior of firms with no operations outside their domestic markets, provided there are strong economic linkages across jurisdictions due, for example, to international trade. To illustrate, the adoption of a price cap in one country may *de facto* imply that firms

[43] Consider the following example: a firm must produce 100,000 units to reach its minimum efficient scale. Demand in the domestic market is 50,000 and potential demand in a foreign market is also 50,000. If the firm is prohibited from engaging in conduct which would allow it to expand in the foreign market, then consumers in both jurisdictions will be harmed.

operating in other markets, whether or not they have operations in the country that introduced the price cap, may also have to price below that cap. This is because parallel trade (i.e., international arbitrage) eliminates prices disparities across countries. Legal linkages might also create a similar result if the antitrust laws of some countries deem prices excessive when they exceed the price charged for the same product elsewhere.[44] Similarly, a change in the quality of an international firm competing in one's domestic market (whether or not it is the firm's domestic market) might affect the decision parameters of other firms operating in that market.

In many circumstances, the access effect and the conduct effect overlap. Indeed, the conduct effect is based upon an access effect. For example, when international firms are prevented from accessing or expanding in foreign markets, their cost structure might be altered in ways which affect their pricing and output decisions in all countries where they operate. In many other cases, however, the access effect is independent. This is likely to be the case, for example, when the jurisdiction implementing the policy change is small in economic terms.

Importantly for our analysis, the access and conduct effects create stronger motivations for coordination than have been previously recognized. Guzman argued in his seminal work that the access effect creates different incentives for different jurisdictions: if a country's exporters hold a dominant position in foreign markets, then that country will prefer a more lenient policy abroad, which would enable its exporters to enjoy their dominant positions freely, and vice versa.[45] Yet the situation

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[44] *See, e.g.,* Case 359/87, Ministere Public v. Tournier, [1989] E.C.R. 2521, [1991] 4 C.M.L.R. 248, ¶ 38, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61987J0395:EN:HTML; O'DONOGHUE & PADILLA, *supra* note 35, at 616-18. A similar effect might result from anti-dumping rules.

[45] Guzman, *International Antitrust*, *supra* note 18, at 1512-17.

of one's exporters in foreign markets might change over time or one's exporters might be dominant in some of a foreign jurisdiction's markets but encounter privately enacted barriers in others. Either of these circumstances might increase the motivation for ensuring that one's trading partners apply monopolization prohibitions correctly. The possibility of a negative conduct effect may further strengthen this motivation.

Interestingly, the conduct effect in the monopolization context was only recently recognized as an important element of international antitrust. This is reflected, *inter alia*, in the fact that the report of the International Competition Policy Advisory Committee (ICPAC) formed by the Department of Justice in 1998 to study antitrust issues related to the internationalization of trade made no mention of possible negative spillovers on the conduct of international firms resulting from the application of monopolization prohibitions elsewhere.[46] As of late, propelled in part by the different standards applied the *Microsoft* cases in both sides of the Atlantic,[47] such externalities command growing attention.

B. The Access and Conduct Effects: Impacts on the Followed Jurisdiction

Having identified the two types of effects created by a jurisdiction's antitrust regime on the welfare of consumers and producers in other countries, we now focus on a specific situation: how the follower phenomenon may impact the followed

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[46] Int'l Competition Policy Advisory Comm., U.S. Dep't of Justice, Final Report (2000), *available at* http://www.usdoj.gov/atr/icpac/finalreport.htm.

[47] *See, e.g.,* Christine A.Varney, Remarks during the American Antitrust Institute Annual Conference, Panel on Re-energizing Section 2 of the Sherman Act (June 19, 2008), (recording available at http://www.antitrustinstitute.org/Archives/Varney.ashx) ("unless we…can sit at the table and jointly continue to pursue the evolution of …section 2, I think…we are not [going to] have a whole lot to say about what abusive dominance looks like for a global firm.").

jurisdiction's welfare through the access and conduct effects. Those externalities may be positive or negative. We discuss each of these two polar cases in turn.

Positive access and conduct effects result when the interests of the jurisdictions with regard to the application of the prohibitions are aligned. The creation of positive externalities does not necessitate one to follow the laws of more established jurisdictions. Nonetheless, such follower conduct plays an important role in their creation. First, it eases access by reducing the learning costs of one's exporters. Second, similarity of laws creates a higher level of possible cooperation in enforcement to deal with issues of mutual concern. But most importantly, if the followed law can effectively limit privately erected barriers to trade, by providing effective regulatory tools or by limiting rent-seeking conduct, then it creates an important tool for opening up foreign markets, thereby generally generating positive access and conduct effects. This creates an added benefit of increased deterrence of international anti-competitive conduct given higher levels of enforcement.[48] Indeed, these are major incentives for motivating foreign jurisdictions to follow another's law. This motivation is further strengthened if some degree of path dependency on the law of the followed jurisdiction is assumed, that is, when the possibility that the followed jurisdiction's antitrust law would also be followed in the future, for example, when its interpretation will change, is increased.

Following the rules of another jurisdiction may alternatively create or strengthen negative externalities on the followed jurisdiction (jurisdiction A). This

[48] Harmonization of laws also makes it easier for jurisdictions to rely on the factual findings of courts in the followed jurisdictions with regard to international cartels. *See* Michal S. Gal, *Free Movement of Judgments: Increasing Deterrence of International Cartels through Jurisdictional Reliance* (New York Univ. Sch. of Law, Law and Econ. Research Paper No. 08-44, 2008), *available at* http://ssrn.com/abstract=1291844.

will occur when that decision (a) limits the ability of jurisdiction A's domestic firms to monopolize foreign markets due to stricter antitrust policies of jurisdiction B based on a correct following of jurisdiction A's antitrust prohibitions;[49] (b) leads to the abandonment of neutral or procompetitive conduct by firms based or operating in jurisdiction A due, for example, to increased costs resulting from parallel and often similar regulation in several following jurisdictions; and (c) increases error costs due to the misapplication of jurisdiction A's complex rules in jurisdiction B with limited institutional capabilities.[50] Let us explore each in turn.

Negative externalities might result from the correct application of the followed law. This may be the case, for example, if a foreign jurisdiction transplants one's antitrust laws and correctly prohibits the monopolizing conduct of one's exporters. Such prohibitions may create negative effects on the followed jurisdiction (A), resulting mainly from the access effect. This concern is, however, limited by the fact that the dominant position of A's exporters in B might change over time or among different industries so that such exporters would thus benefit from stricter law enforcement there.

Negative externalities might further result from the follower phenomenon if the cumulative costs of parallel regulation are prohibitive. Assume, for example, that monopolization prohibitions create a rebuttable presumption of abuse of a certain conduct, and that conduct is eventually found to be legal. The mere costs of parallel regulatory review, resulting from the transplant of the legal presumption, might be

[49] Guzman, *International Antitrust*, *supra* note 15, at 1510-24.

[50] Additional but less significant negative externalities include, inter alia, stronger motivations of international firms to engage in rent-seeking conduct in the followed jurisdiction, given that a change in its law may affect other jurisdictions as well, and reduced use of diverse laws as legal laboratories.

sufficiently high to prevent the monopolist from engaging in such conduct in the first place, despite its procompetitive or neutral welfare effects. Accordingly, unless profits grow in parallel with the increase in regulatory review costs, procompetitive conduct might be prevented.

Finally, transplanted prohibitions might be welfare-reducing both for the following market as well as for the followed one, if they are misapplied. Misapplication might be caused by erroneous applications of the followed law, resulting from the combination of a high complexity of transplanted rules and limited institutional capabilities in jurisdiction B. This comports with studies that indicate that when courts do not understand complex competition issues, they often face problems in applying the law.[51] It might also result from following a wrong decision of the followed jurisdiction (A).

The appendix includes a simple model that exemplifies the access and the conduct effects when jurisdiction B follows the laws of jurisdiction A.

III. POTENTIAL RESPONSES BY THE FOLLOWED JURISDICTION

Given the possible externalities created by the access and conduct effects analyzed above, this part investigates the tools that can be applied by the followed jurisdiction to increase its own welfare in response to the follower phenomenon. Developing such tools seems particularly pressing in light of the possible rise of new antitrust jurisdictions, most notably China and India, which enhance the potential for externalities.

[51] Int'l Competition Network, Competition Policy and Implementation Working Group: Subgroup 3, *Competition and the Judiciary: A Report on a Survey on the Relationship Between Competition Authorities and the Judiciary*, at 8-9 (2006), *available at* http://internationalcompetitionnetwork.org/uploads/library/doc594.pdf.

A. Applying Domestic Antitrust Laws to Limit Negative Externalities

One possible tool to limit some negative externalities resulting from the misapplication of foreign monopolization provisions is the application of domestic antitrust laws to foreign conduct. For example, a foreign cartel that blocks access of one's exporters into foreign markets might be prohibited under one's domestic antitrust laws. Indeed, the United States has declared that it can apply its antitrust laws to conduct abroad that restrains U.S. exports and has done so in several cases.[52]

This solution is, nonetheless, very limited. First, it cannot limit the negative externalities that result from the prohibition of conduct of an international firm that does not restrain one's exporters' access to foreign markets. Second, it does not deal with the negative externalities resulting from the correct application of followed laws elsewhere. Furthermore, this solution encounters difficulties of establishing jurisdiction, overcoming potential objections to offshore discovery, conducting the investigation, establishing proof, and enforcing the remedy abroad.[53] But most importantly, it creates significant jurisdictional conflict, since it extends the application of one's laws to issues generally viewed as coming under foreign jurisdictions' sovereignty. Indeed, many jurisdictions reacted negatively to the U.S. extension of its laws, and, in fact, the United States rarely applied its antitrust laws to limit access barriers elsewhere.[54] Also, its application largely depends on the balance of powers between the jurisdictions.

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[52] U.S. Dep't of Justice and Fed. Trade Comm'n,, Antitrust Enforcement Guidelines for International Operations (1995) § 3.1, *available at* http://www.usdoj.gov/atr/public/guidelines/internat.htm.

[53] ICPAC Report, *supra* note 46, at 245.

[54] The ICPAC Report identified only five such cases in the past thirty years. *Id.*, at 24 & n.159.

B. AIDING AND DIRECTING FOREIGN ANTITRUST ENFORCEMENT

An important way to increase the positive externalities of the follower phenomenon and reduce its possible negative effects resulting from misapplication or from burdensome regulatory costs is to ensure that the foreign law is applied correctly. Indeed, many of the current international antitrust activities fall within this framework. Technical assistance programs, designed to assist a foreign jurisdiction in efficiently designing its antitrust laws and in strengthening its institutional capacity, serve such a function. Efforts of international bodies such as the International Competition Network (ICN), Organization on Economic Cooperation and Development (OECD), World Bank, and the United Nations Conference on Trade and Development (UNCTAD) to increase the understanding of the conditions needed to apply antitrust prohibitions and their suggestions for recommended practices also serve a similar function.[55] Finally, consultation among jurisdictions in analyzing specific cases can also reduce negative externalities.

Yet such tools might not always provide an efficient solution. Most importantly, they generally do not significantly change the institutional capacity of decision makers in the following jurisdiction. Guidance and assistance might need to be given on an ongoing basis to ensure that the law is applied correctly. Moreover, international best practices are sometimes based on an assumption that a high level of

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[55] For examples of these efforts, see, for example, World Bank & Organization on Economic Cooperation and Development, A Framework for the Design and Implementation of Competition Law and Policy (1999), *available at* http://rru.worldbank.org/Documents/PapersLinks/2427.pdf; Organization on Economic Cooperation and Development, Best Practice Roundtables on Competition Policy, *available at* www.oecd.org/competition/roundtables; United Nations Conference on Trade and Development, Model Law on Competition(2007), *available at* http://www.unctad.org/en/docs/tdrbpconf5d7rev3_en.pdf. For an analysis of such efforts see, for example, D. Daniel Sokol, *Monopolists Without Borders: The Institutional Challenge of International Antitrust in a Global Gilded Age*, 4 BERKELEY BUS. L. J. 37, 81-116 (2007).

analysis can be applied. Indeed, international bodies often fall into the trap of advocating the best law under optimal conditions, while giving insufficient weight to decision-theoretic considerations. This can be exemplified, *inter alia*, by the ICN recommendation on the proof of market power, which requires an in-depth economic analysis of the conditions in the market.[56] Also, jurisdictions might not agree to apply laws that differ from those applied elsewhere, for the reasons explored above. Accordingly, additional tools might be needed to increase the welfare effects of the follower phenomenon.

C. CHANGING THE CONTENT OF ONE'S LAWS

A known children's tale, "Caps for Sale", tells the story of a hat merchant who falls asleep under a tree just to find out that his hats–all but one–have been stolen by a group of monkeys.[57] In his efforts to get his hats back, the merchant learns that the monkeys simply copy his moves. He then throws his hat on the ground, and when the monkeys follow, he collects his hats. There is some resemblance between this story and the follower phenomenon. Obviously, in both cases one copies the acts of another. But the resemblance extends beyond this simplistic comparison. In what follows, we shall argue that, at least in some extreme cases, it might be worthwhile for the followed jurisdiction to change the content of its laws to increase its own welfare, once the follower phenomenon is taken into account. The analogy to the children's story thus extends as follows: in both cases the main actor takes an action that on its

[56] Int'l Competition Network, Dominance/Substantial Market Power Analysis Pursuant to Unilateral Conduct Laws, Recommended Practices (2008), *available at* http://www.internationalcompetitionnetwork.org/uploads/library/doc317.pdf. For a discussion of the benefits for small jurisdictions from the use of market-share-based presumptions of market power see, for example, Michal S. Gal, *Antitrust in a Globalized Economy: The Unique Challenges of Small and of Developed Economies*, 33 FORDHAM INT'L L. J. (forthcoming 2009) (manuscript at 142, on file with authors).

[57] ESPHYR SLOBODKINA, CAPS FOR SALE (n.d.).

face harms him (throwing the only hat he has left and changing a law that is optimal for internal domestic regulation), unless the externalities, which result from the follower's conduct, are taken into account.

This can be illustrated in the case of merger review.[58] The United States adopted ex ante merger review before most countries had an antitrust law. The regulatory model adopted requires that parties to mergers that come under a predetermined threshold must notify the competition authority of their planned transaction and observe a waiting period intended to give the competition authority an opportunity to investigate and possible challenge the transaction. This review system may have been optimal when applied only or mainly in the United States. However, it might not be optimal once followed around the world, since international mergers must now seek the approval of numerous jurisdictions. Even if most jurisdictions do not prohibit such mergers, the cumulative notification costs can be very high.[59] Had that been expected, it might have been wiser to adopt a different regulatory regime, for example one that relies primarily on ex-post review and challenge of international mergers that significantly limit competition, rather than ex ante regulation, , while granting parties the ability to request a premerger ruling to reduce their uncertainty. It is probably too late to roll back this ball, but it may not be too late to change at least some of the rules that regulate monopolistic conduct.

The incentives of the followed jurisdiction to change the content of rules that are likely to be followed elsewhere are influenced by the relative size of two factors: (a) the effect of the altered rule as compared to the old one on the followed

[58] *See, e.g.,* Int'l Bar Ass'n, *supra* note 7.
[59] *See, e.g.,* Int'l Competition Network, *Report on the Costs and Burdens of Multijurisdictional Merger Review* (2004), *available at* http://www.internationalcompetitionnetwork.org/uploads/library/doc332.pdf (surveying previous studies estimating such costs).

jurisdiction's welfare when applied in domestic markets (disregarding externalities); and (b) the relative effect on the followed jurisdiction's welfare resulting from the possibility of application of each of the two rules elsewhere (externalities). Only if the positive effects on the followed jurisdiction's welfare resulting from changing the law in the following jurisdiction are significantly higher than the negative effect on domestic welfare resulting from the legal change in the followed jurisdiction, should the law be altered.

The efficiency of altering domestic law increases, inter alia, with the likelihood that it will be imitated by foreign jurisdictions; that the following jurisdiction will apply the law incorrectly; and the impact of foreign laws on the followed jurisdiction's domestic consumer welfare. The magnitude of the latter depends, in turn, on the access and conduct effects.

This can be illustrated as follows. The level of expected externalities imposed by Cuba on the United States, should it follow its monopolization prohibitions, is very low. This is because exports are nonexistent, and thus there is no possible access effect. Although some international firms operate in both markets, Cuba will not be able to create a veto effect, given its small size. Thus, there is also no possible conduct effect. Accordingly, there is no incentive to change the content of the followed law. This, of course, is an extreme example. But even if we change Cuba with Barbados, the analysis would not change significantly, given the small size of the Barbadian market.

The level of expected externalities imposed by China on the European Union, should China adopt the EU's monopolization prohibitions, on the other hand, is very high, especially if we compare it to no adoption at all but even if we compare it to the adoption of a less restrictive prohibition. Access costs might be significant. This is because export levels are significant and China is expected to apply its laws in practice. Access effects might be magnified by the fact that China's arguably low institutional capacity would lead to increased error costs. Furthermore, a conduct effect is also possible: many international firms operate in both markets and given its sheer size China can create a veto power when applying its prohibitions. Such prohibitions will create externalities if the international firm cannot differentiate its conduct in China and the European Union or if such limitations weaken its competitiveness elsewhere.

As the above indicates, the follower phenomenon may thus sometimes change the optimal content of one's laws. This might not be the first-best solution. Rather, educating foreign legislators in the possible welfare-reducing effects of following a complex rule, or in the correct way to apply such rules, or entering into bilateral agreements with major trading parties about the application of their laws might be preferred solutions. However, these solutions are not without their limitations. Some shortcomings of technical assistance were elaborated above. Bilateral agreements are also not a panacea, especially given the cumulative effect of externalities that may be created by jurisdictions that are not party to the agreement, as is apparent in the merger review area. Accordingly, a legal change should be considered only in rare cases in which other solutions are clearly less efficient and the level of negative externalities created by the old rule is very high relative to the costs of the change on internal enforcement.

Predatory pricing regulation exemplifies the effects of institutional competence. Some economists suggest that the predatory pricing prohibition should also include above-cost prices, since the current rule does not capture all the instances of predatory pricing.[60] However, due to the complex analysis required in assessing above-cost prices, such a rule will most likely significantly increase error costs in jurisdictions with limited institutional capacity for economic analysis.[61] Thus, it might be optimal not to alter the existing rule.

An important drawback of this solution relates to the issue of who creates the law that is then followed. The legislature is, of course a major source of domestic law, as well as the antitrust authority and the courts. All three institutions are, in turn, affected by socio-economic ideologies, scholarly work, and even political influences. This, in turn, implies that it might be difficult to tightly control the substance of domestic law to take into account the follower phenomenon. Moreover, currently the externalities generated by it do not form part of the considerations that courts and antitrust agencies take into account when interpreting domestic law, despite the fact that such an inclusion can be justified under a domestic welfare analysis. However, this does not mean that this route should be closed. Rather, the legislature may change the domestic law or specifically allow decision makers to take the follower phenomenon into account. Even if these steps do not ensure that the followed law will be altered optimally, it may still have some positive influence on the content of the followed law.

Finally, the effect on domestic welfare resulting from the internal application of a rule and the externalities from the application of rules elsewhere can in some cases be separated. The creation of model laws and the strengthening of motivations to follow such laws might be regarded as ways to limit some of the negative

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[60] *See, e.g.,* Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L. J. 941 (2002).

[61] *See, e.g.*, Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory--and the Implications for Defining Costs and Market Power*, 112 YALE L.J. 681 (2003).

externalities created by the following of complex or vague antitrust laws of established jurisdictions.[62] If model laws are simplified and versions of existing antitrust laws clarified, then they might reduce error costs. There is, however, one main problem with model laws: since no established antitrust regime has experienced their application and there is limited scholarly commentary that relates to them, in applying them in practice jurisdictions may refer, once again, to the antitrust laws of more established jurisdictions. Such secondary transplant might even be worse than a primary one, since it can create inconsistency and lack of clarity.

IV. CONCLUSIONS

Antitrust is oftentimes characterized by the transplant of rules of established antitrust regimes and by mutual learning. One of the most followed provision is the EU monopolization prohibition, which was copied by more than forty-three jurisdictions.[63] This follower phenomenon is motivated by both external and internal forces. The follower phenomenon does not affect only domestic welfare. Rather, it creates externalities on other jurisdictions, given the jurisdictional interface that arises from the unilateral application of national antitrust policies to cases with cross-border effects.

In this paper we analyzed the follower phenomenon and its effects on both the following and the followed jurisdictions. Our main insight is that the choice of optimal antitrust law in a given country may be conditioned by the possibility that such a law is followed by other countries and create externalities on the followed jurisdiction. Antitrust laws that increase domestic welfare in a closed economy may no longer be desirable in an open economy when other jurisdictions follow the

[62] UNCTAD, supra note 55; WORLD BANK & OECD, supra note 55.

[63] *See* note 19 *supra*.

domestic laws. This effect is most significant when foreign antitrust laws can affect the behavior of domestic firms at home, and not only overseas.

This observation also has implications for the motivations for the harmonization of antitrust laws. Guzman suggested that although in principle antitrust harmonization is highly desirable, in practice it might be impossible to negotiate substantive international antitrust agreements given that strong exporters prefer that the national antitrust policies of their export markets be more permissive than those that maximize global welfare.[64] In this article we show that other motivations might push in the other direction, thus requiring jurisdictions to balance competing motivations. On the one hand, the motivation to exploit foreign markets by ensuring that they do not have sound antitrust policy that blocks the anti-competitive conduct of one's exporters. On the other hand, the motivation to ensure a correct application of foreign antitrust law in order to limit abuses by other firms operating in the foreign market that harm access of one's firms to the foreign market and to correctly regulate the conduct of international firms that would then affect conduct in domestic markets. It is thus not surprising that most efforts in international antitrust have thus far focused on educating jurisdictions in the correct application of antitrust laws and in creating best practices.

The article has implications beyond antitrust. Scholarly work on legal transplants has focused on the transplanting jurisdiction: whether or not the transplant can take root and grow in it. It has not focused on the effect of the transplant on the followed jurisdiction. This article took some steps in analyzing such effects in the context of monopolization and the way to increase their positive externalities. The analysis can apply, with some changes, to other areas of law as well.

[64] Guzman, *International Antitrust*, *supra* note 15, at 1512-17.

APPENDIX: A SIMPLE MODEL

This Appendix illustrates the access and conduct effects discussed above by means of a simple model. It is intended to exemplify the nature of the access and conduct effects and their implications regarding the follower phenomenon by providing a detailed illustration of such effects and implications under a given set circumstances, elaborated in the model.

Consider a global economy with two countries, *A* (the followed country) and *B* (the following country), and two firms, *a* and *b*. Firm *a* monopolizes country *A* (firm *a*'s domestic market) and competes à la Cournot with firm *b* in country *B* (firm *a*'s foreign market and firm *b*'s domestic market). Firm *a* also enjoys a dominant position in country B.[65]

Firm *a*'s profits are given by the following expression $\pi_a = \pi_a^A + \pi_a^B = \left[p_a^A q_a^A - c_a^A q_a^A \right] + \left[p_a^B q_a^B - c_a^B q_a^B \right] - \zeta(I_a)$, where q_a^G denotes the output of firm *a* in country *G = A, B*, p_a^G denotes the price charged by firm *a* in country *G*, c_a^G denotes the unit cost of production of firm *a* in country *G*, where $c_a^G = c\left(q_a^G\right), c' > 0, c'' > 0$ for all $G = A, B$, and I_a denotes firm *a*'s investment in product quality, where $\zeta(I_a),$ with $\zeta' > 0$ and $\zeta'' > 0,$ represents the costs associated with investment I_a.

[65] This example can be generalized to situations where there is at least one firm with market power in country *A*. From a legal viewpoint, however, it is unlikely that firm *a* in country *A* will be constrained by an excessive pricing regulation unless it has considerable market power in *A*.

Firm a's production levels in countries A and B are given by the following expressions: $q_a^A = q_a^A\left(p_a^A, I_a\right)$ and $q_a^B = q_a^B\left(p_a^B, p_b^B, z\right)$ with $z = z(I_a)$. That is, the quantity sold by firm a in country A is decreasing in its own price and increasing in the quality of its products, which in turn is a function of its investment in product quality. The quantity sold by firm a in country B is also decreasing in its own price, but is increasing in the price of firm b and in the quality differential z, which in turn increases with firm a's investment.[66] Note that the quality differential z equals zero, that is, the products of firms a and b have the same quality, when I_a equals zero. In addition, and for simplicity, we assume that the demand functions faced by firms a and b are such that $p_a^B = p_b^B + z$.[67]

Likewise, firm b's profits are $\pi_b = \pi_b^B = \left[p_b^B q_b^B - c_b^B q_b^B\right]$, where q_b^B denotes the output of firm b in country B, p_b^B denotes the price charged by firm b in country B, and c_b^B denotes the unit cost of production of firm b in country B, where $c_b^B = c\left(q_b^B\right), c' > 0, c'' > 0$. Firm b's production level in country B is given by: $q_b^B = q_b^B\left(p_a^B, p_b^B, z\right)$. That is, the quantity sold by firm b in country B is decreasing in its own price but increasing in the price of firm a and decreasing in the quality differential z.

Consumer welfare in country A is given by: $W^A = W^A\left(q_a^A, p_a^A, I_a\right)$. Similarly, consumer welfare in country B is given by $W^B = W^B\left(q_a^B, q_b^B, p_a^B, p_b^B, I_a\right)$. As standard,

[66] For simplicity we assume that firm b cannot improve the quality of its product through positive investment. This assumption does not have an impact on the nature of the various effects identified below, although it may have an impact on the relative magnitude of those effects.

[67] That is, $p_b^B = f(q_a^B + q_a^B)$ and $p_a^B = f(q_a^B + q_a^B) + z$.

consumer welfare is increasing in (aggregate) output and product quality, and decreasing in price(s).[68]

In the absence of any antitrust intervention, firm *a* will choose I_a and firms *a* and *b* will choose output in countries *A* and *B* so as to maximise their own profits, taking as given the choice(s) of the rival. The industry equilibrium will be given by a vector $\left\langle q_a^{A,*}, q_a^{B,*}, q_b^{B,*}, I_a^* \right\rangle$, so that $\left\langle q_a^{A,*}, q_a^{B,*}, I_a^* \right\rangle$ maximizes π_a for given $\left\langle q_b^B \right\rangle$ and $\left\langle q_b^{B,*} \right\rangle$ maximizes π_b for given $\left\langle q_a^A, q_a^B, I_a \right\rangle$. This equilibrium configuration determines equilibrium prices, profits and consumer welfare levels in the two countries: $\left\langle \pi_a^*, W^{A,*} \right\rangle; \left\langle \pi_b^*, W^{B,*} \right\rangle$.

Note that in this model the main linkage between both countries is given by the level of investment I_a. Firm *a* invests in product quality in order to boost its demand in country *A*, where it enjoys a monopoly position, and also to differentiate its offering in country *B*, where it competes with firm *b*. By increasing I_a firm *a* steals business from firm *b* in country *B*. Firm *a*'s incentives to invest in product quality depend on the expected profitability of that investment in countries *A* and *B*. As we will see below, a regulatory measure that reduces the expected return of that investment in one country will cause I_a to fall and, therefore, will cause a negative externality on the other country's consumers.

1. *Antitrust Intervention in Country A*

In this section we consider the implications for firms *a*'s and *b*'s profits and for consumer welfare in countries *A* and *B* of the introduction of excessive pricing legislation in country *A*. In particular, we assume that firm *a*'s price in country *A* is

[68] The positive effect of increased quality on consumer welfare is reflected in these functions via aggregate output. An increase in quality implies greater output for given prices and hence greater welfare.

constrained to be below $\overline{p}^A$. Our analysis and its results are equally applicable to antitrust interventions against exclusionary conduct. Those interventions, if successful, also constrain firm *a*'s ability to charge supra competitive prices.

We assume that $\tilde{p}^A < \overline{p}^A < p_a^{A,*}$, where $\tilde{p}^A$ denotes the competitive price (i.e., the price at which firm *a*'s marginal cost of production in country *A* intersects the demand curve), while $p_a^{A,*}$ represents firm *a*'s monopoly price (i.e., the price at which its marginal cost production in country *A* equals its marginal revenue in that country). The monopoly price $p_a^{A,*}$ represents the price that would prevail without intervention. The imposition of a price cap $\overline{p}^A > \tilde{p}^A$ on firm *a*'s price causes firm *a*'s output in country *A*, q_a^A, to increase and its profits in that country, π_a^A, to fall. The reduction in profits then reduces the marginal profitability of investing in product quality, so I_a also falls. This, in turn, depresses the demand for firm *a*'s product in country *B*, q_a^B, which causes firm *a*'s profits in country *B* to fall and further reduces the incentives of firm *a* to invest in product quality I_a.

The effect of the introduction of excessive pricing legislation on consumer welfare in country *A* is ambiguous. Consumers benefit from a lower price but are made worse off by the reduction in product quality. [69] In addition, they may or may not benefit from greater output. That depends on the balance between two opposing effects. On the one hand, the reduction of prices leads to higher output; on the other, the reduction in quality reduces demand and hence output. In what follows we assume

[69] Given the static nature of our model, this effect appears to be contemporaneous to the changes in prices and output levels. In practice, however, this effect will only take place gradually. That is, the reduction in quality, relative to the level that might have been if the firm's investment in quality remained on its previous level, will only materialize in the long run.

that the price cap, $\overline{p}^A$, is set at a level such that the first effect dominates so that the impact of the antitrust legislation is unambiguously positive. Under this assumption, the regulation of firm *a*'s prices produces an increase in consumer welfare in country *A*.

2. *Spillover Effects and Policy Response in Country B*

The introduction of excessive pricing legislation in country *A* has significant implications on country *B*. The reduction in firm *a*'s investment in quality improves the relative competitive position of firm *b* in country *B*. As a result, firm *b*'s output, q_b^B, increases. Furthermore, under standard regularity conditions,[70] firm *b*'s profits, π_b^B, also increase. This is because q_b^B increases and, since aggregate output in country *B* is reduced under those regularity conditions, p_b^B post-intervention is greater than or equal to the price that *b* charged prior to the antitrust intervention in country *A*.

So, the adoption of an interventionist policy towards excessive pricing in country *A* can generate a *positive* externality on the firms of those countries whose companies compete with the companies located in country *A* in foreign markets (i.e., firm *b* in country *B*). Yet the adoption of an interventionist policy towards excessive pricing in country *A* is likely to generate a *negative* externality on the consumers of those same countries (i.e., consumers in country *B*). They are made worse off because (i) the quality (and the price/quality ratio) of the products offered by firm *a* is reduced

[70] That is, demand functions are decreasing and twice-differentiable, cost functions are increasing and twice-differentiable, profit functions are concave in output, marginal returns are decreasing and the output of firms *a* and *b* in country *B* are strategic substitutes. *See* XAVIER VIVES, OLIGOPOLY PRICING: OLD IDEAS, NEW TOOLS ch. 4 (2001). These assumptions are required to ensure intuitive comparative static results. *Id.* at 102.

and (ii) firm *b*'s prices increase. Note that (i) and (ii) are both conduct effects caused by the reduction in firm *a*'s profits in country *A*.

Country B may respond to country *A*'s antitrust policy by mimicking it to protect its consumers. Whether it does so will depend on the objective function of country *B*'s politicians and, in particular, on the weight attributed to the competitiveness of their domestic companies relative to consumer welfare in that objective function. We assume that country *B*'s politicians are mainly driven by consumer welfare and therefore impose a price cap on the prices of firm *a*, which (still) holds a dominant position in country *B*, in response to country *A*'s antitrust reform. That is, $p_a^B < \widehat{p}^B$.

Suppose that $\widehat{p}^B > \tilde{p}^B$, where $\tilde{p}^B$ denotes the competitive price (i.e., the price at which firm *a*'s marginal cost of production in country *B* intersects the demand curve for its product). For a given level of investment I_a, the reduction in prices will cause an increase in firm *a*'s output q_a^B but a reduction in its country *B* profits π_a^B. This reduction in profits will in turn further reduce firm *a*'s incentives to invest in quality.

3. *Implications for the Followed Country*

Country *B*'s antitrust policy has a number of implications for firm *a* as well as for country *A*'s consumers. First, country *B*'s decision to follow harms firm *a*'s competitive position in country *B*. This is an access effect resulting from the application of competition law in the following country on the followed country: country *B*'s policy response makes it more difficult, and thus less profitable, for firm *a* to attract country B's consumers and, consequently, reduces the profitability of operating in that country.

This effect not only reduces firm *a*'s profits, it also has implications for consumers in country *A*, even if country *B*'s price cap policy does not directly constrain firm *a*'s prices in country *A*. Consumers in country *A* can be made worse off because country *B*'s intervention reduces incentives of firm *a* to invest in the quality of its products, which in turn will cause a reduction in output in country *A*. In other words, the policy decision made in country *B* generates a negative conduct effect on consumer welfare in country A.

Figure 1 below illustrates this effect for the case where the price cap $\overline{p}^A > \tilde{p}^A$ is still binding after the reduction in I_a. The fall in level of investment I_a shifts the demand function in country *A* inwards, which, if the new profit maximising price remains above $\overline{p}^A$, results in a reduction in output equal to the difference $(\overline{q} - \overline{q}(\widehat{p}^B))$ and, hence, a reduction in consumer welfare given by the shaded area in Figure 1.

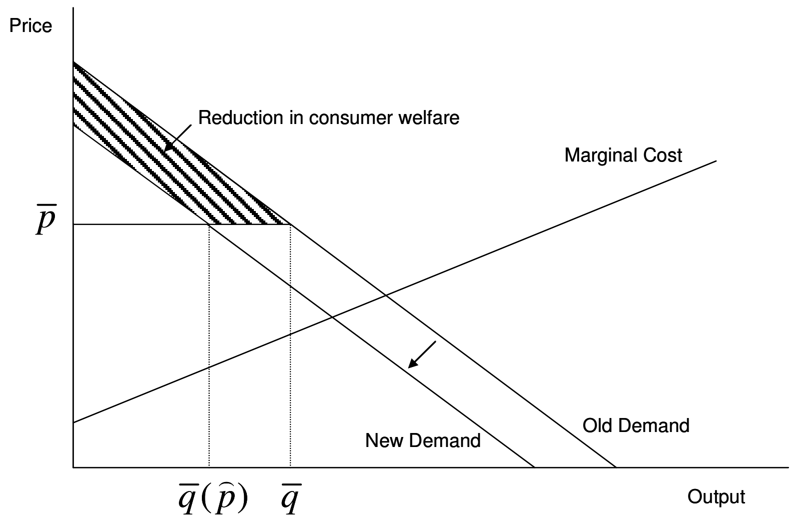

FIGURE 1: THE IMPACT OF A PRICE CAP IN COUNTRY B ON COUNTRY A'S CONSUMER WELFARE

Second, there may be circumstances when the policy introduced by country *B* affects the conduct of firm *a* in country *A*. For example, as explained above, the adoption of a price cap $\widehat{p}^B$ in country *B* may effectively constrain firm *a* and require it to set its price below $\widehat{p}^B$ in country A as well. This may be because parallel trade (i.e., international arbitrage) eliminates prices disparities across countries, or because competition law in country *A* deems a price excessive when it exceeds the price charged for the same product in other countries (thus forcing firm *a* to pay attention to the regulation imposed in all those markets where it operates).

Under such circumstances, the price cap $\widehat{p}^B$ will further reduce firm *a*'s profits in country *A* and hence cause a new reduction in I_a. In addition, output in country *A* will fall when (1) $\overline{p}^A > \widehat{p}^B > \tilde{p}^A$ or (2) $\widehat{p}^B < \tilde{p}^A$. In the first case, the reduction in output caused by a fall in I_a more than offsets the increase in output resulting from a reduction in p_a^A. In the second case, the reduction of firm *a*'s price below its competitive level causes a reduction in output which is compounded by the reduction in output resulting from the fall in quality.

Figure 2 below illustrates the reduction in output in country *A* resulting from the imposition of a price cap $\widehat{p}^B < \tilde{p}^A$ under the simplifying assumption that I_a remains unchanged. Note that under the new price cap demand is rationed.

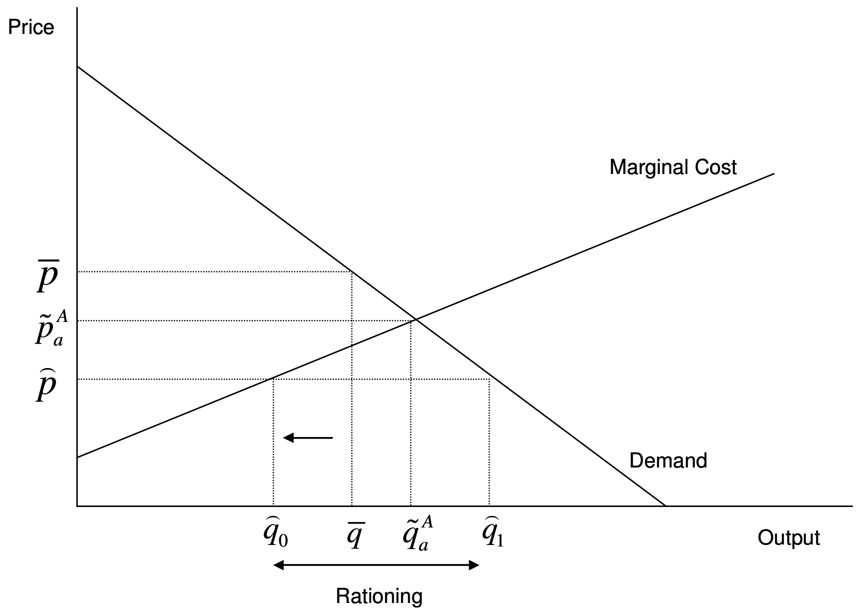

FIGURE 2:
THE IMPACT OF A PRICE CAP $\widehat{p} < \tilde{p}^A$ ON COUNTRY *A*'S OUTPUT

The impact of the conduct effect on country *A*'s consumers is in principle ambiguous. Consumers are made worse off by the reduction in quality and output but do benefit from reduced prices.

4. *Misapplication of Antitrust Law in the Following Country*

The welfare impact of the conduct effect may be particularly important when country *B*'s antitrust law results in type I errors. To illustrate this claim, consider a slight modification of the model analysed above.

So far we have assumed that the price cap imposed by the competition authorities in country *B*, $\widehat{p}^B$, was greater than $\tilde{p}^B$, the competitive price in country *B*. This is an important assumption because for $p > \tilde{p}^B$, any reduction in prices leads to an increase in output, whereas for $p < \tilde{p}^B$, the opposite is true. So, the impact on consumer welfare in country *B* of a price cap $\widehat{p}^B$ that is set well below $\tilde{p}^B$ is more likely to be negative. Output would fall as a result of (a) the reduction in prices and (b) the reduction in I_a. In other words, a regulatory intervention against excessive prices in country B that penalises any price above $\widehat{p}$, when $\widehat{p}^{B}$ is sufficiently low, may cause a type I error or a false positive and therefore may make consumers in that country worse off. Of course, this misapplication is also likely to have negative welfare effects in country A due to both access and conduct effects.