REGULATION BY DECLARATION: A NOVEL REGULATORY MECHANISM TO LIMIT ABUSE OF MONOPOLY POWER

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INTRODUCTION

A known children's fable, by the famous fabulist Aesop, tells the tale of the mouse council which met urgently in order to discuss the deeds of their great eternal enemy, the cat.[1] The cat's swift movements to remove its enemies, its power and its strong bite, did not leave the small and frightened mice that crossed its way much chance against it. All agreed that if they could find a way to be warned in time of the cat's approach, they could be saved from their horrible fate. But how could they achieve this task? Complete silence ensued. Suddenly, a small hand was raised in the back of the room, and a young mouse said: "I have an idea! Let's tie a bell around the cat's neck!" The suggestion was immediately accepted, with great enthusiasm. When the noise finally died down, one of the old mice said: "It is indeed a great plan, but how do we tie the bell to the cat's neck?"

There is some similarity between the situation of the mice in the fable and that of small firms that operate in a market dominated by a monopolist. A monopolist might abuse its market power and harm its competitors in order to increase or to maintain its market power. It might, for example, enter into exclusive dealing contracts with the main suppliers or distributors in the market, thereby making it more difficult for its

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1. LIDA BROWN MCMURRY, FIFTY FAMOUS FABLES 15 (2004).

competitors to operate.[2] It might tie its dominant product to another product without efficiency justifications, thereby harming competition in the market of the tied product by distorting the incentives of consumers to choose among the products offered in the tied product's market.[3] The antitrust laws prohibit such conduct, which creates artificial barriers to competition and inhibits the replacement of incumbent monopolists by more efficient firms.[4]

The first step in any regulatory initiative to prevent abusive conduct by a monopolist is defining the monopoly as such. Monopoly is defined based on the existence of a high degree of market power.[5] The question of whether a firm actually holds sufficient market power to be legally defined as a

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2. *See, e.g.*, United States v. Microsoft Corp., 253 F.3d 34, 82 (D.C. Cir. 2001), *cert. denied*, 122 S. Ct. 350 (2001); Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal - Why Aspen and Kodak Are Misguided*, 68 ANTITRUST L.J. 659 (2001).

3. *See, e.g.*, Eastman Kodak Co. v. Image Tech. Serv., Inc., 504 U.S. 451 (1979); *Microsoft*, 253 F.3d at 66.

4. Sherman Antitrust Act, 15 U.S.C. § 2 (2000); Federal Trade Commission Act, 15 U.S.C. § 45 (2000). There is currently much debate about the scope of the monopolization prohibitions, as the difference between use and abuse of market power is hard to ascertain from existing case law. *See, e.g.*, Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253 (2003); Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. 147 (2005); MICHAL S. GAL, COMPETITION POLICY FOR SMALL MARKET ECONOMIES, ch. 3 (2003). Yet there seems to be an agreement that certain types of conduct by a monopolist are and should be prohibited. Hovenkamp, *supra*, at 147; Gal, *supra*, at §3; 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION § 651 (2d ed. 2004). This article is largely based on the common assumption that at least some categories of abusive conduct are relatively clearly defined and should be prohibited in order to increase social welfare. The effects of the uncertainty regarding the scope of some monopolization prohibitions on the regulatory mechanism proposed in this paper are analyzed in *infra* Part II(B)(3).

5. Market power is the ability of a firm (or a group of firms, acting jointly) to raise price above the competitive level without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded. For the seminal article on this subject see William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 951 (1981). Some courts have adopted an additional test that focuses on the ability to exclude competitors. *See, e.g.*, United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 391 (1956). The monopolization offense requires "substantial" market power. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE, 270-3 (3d ed. 1999).

monopoly is currently answered by the regulatory authorities or the courts only when prohibitory or compensatory actions are considered, as an integral part of an analysis into whether an abuse of market power has occurred.[6] This can be illustrated by the Microsoft case. The first part of the court's ruling focused on whether Microsoft had sufficient market power to be defined a monopoly. Only after the court decided that the evidence supported such a finding, did the analysis center on whether Microsoft had abused its power.[7]

This mechanism suffers from several significant disadvantages. Most notably, since the definition of monopoly is very difficult to apply[8] and creates a high degree of uncertainty surrounding a would-be monopolist's market position, the incen-

6. "The threshold element of a § 2 monopolization offense [is] 'the possession of monopoly power in the relevant market.'" United States v. Microsoft Corp., 87 F. Supp. 2d 30, 36 (D.D.C. 2000) (quoting United States v. Grinell Corp., 384 U.S. 563, 570 (1996)); Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 COLUM. L. REV. 1805, 1807 (1990) ("In monopoly enforcement under section 2 of the Sherman Act, the pivotal inquiry is almost always whether the challenged party has substantial market power in its relevant market.") (internal citations omitted).

7. United States v. Microsoft Corp., 84 F. Supp. 2d 9 (D.D.C. 1999) (findings of fact); United States v. Microsoft Corp., 87 F. Supp. 2d 30 (D.D.C. 2000) (conclusions of law); United States v. Microsoft Corp., 97 F. Supp. 2d 59 (D.D.C. 2000) (final judgment); United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (Unsuccessful appeal from finding of fact that Microsoft has monopoly power).

8. For some of the problems involved in defining a firm a monopoly see, for example, PHILLIP E. AREEDA, LOUIS KAPLOW & AARON EDLIN, ANTITRUST ANALYSIS: PROBLEMS, TEXT AND CASES, ¶ 342 (6th ed. 2004) ("The inquiry into market power is itself costly and subject to mistakes."); HOVENKAMP, *supra* note 5, at 272-75. Generally, the first step in a market power analysis is defining the relevant market. However, as many courts and commentators have noted, "there is no subject in antitrust law more confusing than market definition." United States Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 598 (1st Cir. 1993). *See also* Telecor Commc'n, Inc. v. Southwestern Bell Tel. Co., 305 F.3d 1124, 1131 (10th Cir. 2002); Dennis W. Carlton, *Using Economics to Improve Antitrust Policy*, COLUM. BUS. L. REV. 283, 284 (2004); Lawrence J. White, *Market Definition in Monopolization Cases: A Paradigm Is Missing*, *in* ISSUES IN COMPETITION LAW AND POLICY (Wayne d. Collins ed. forthcoming) (noting that there is no settled method to define relevant markets in monopoly cases). Yet defining the relevant market and calculating the market share of the relevant firm are "only a starting point for determining whether monopoly power exists, and the inference of monopoly power does not automatically follow from the possession of a commanding market share." Am. Council of Certified Podiatric Physicians &

tives of market participants to actively monitor the conduct of a possible monopolist might be significantly reduced. This, in turn, increases the incentives of the monopolist to engage in abusive conduct. Moreover, if a firm is uncertain about its market position, this might lead to over-deterrence in order to avoid costly legal sanctions if the firm wrongly assumes it holds a monopolistic position, or to under-deterrence if it wrongly assumes that it does not hold such a position. As a consequence, in order to deter abuses of market power, sanctions against monopolists that have been found to abuse their market power have to be increased.[9] This, in turn, further increases the over-deterrence effect. In addition, the existing regulatory mechanism might be wasteful if private parties who bring separate suits against a monopolist each have to prove, separately, that the relevant firm possesses sufficient market power to meet the legal requirements.[10]

To solve these problems, and to limit the abuse of monopoly power, this article suggests a novel regulatory mechanism. The essence of the proposal is the separation of the two stages of the existing regulatory process: the finding of monopoly power and the finding of an abuse. It is suggested that the regulatory authorities be empowered to issue a declaration of a firm as a monopoly, even when no specific abuse is claimed, and that such a declaration be used as *prima facie* evidence for the existence of a monopoly in judicial proceedings. Some of

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Surgeons v. Am. Bd. of Podiatric Surgery, Inc., 185 F.3d 606, 623 (6th Cir. 1999).

> Factors such as competitiveness of the market, number and strength of competitors, market trends and the presence or absence of significant barriers to entering the market also are useful in determining whether a defendant has monopolized a market.

Re/Max Int'l v. Realty One, 924 F. Supp. 1474, 1489 (N. D. Ohio 1996), *rev'd in part on other grounds*, 173 F.3d 995 (6th Cir. 1999) (citing Bacchus Indus., Inc. v. Arvin Indus., Inc., 939 F.2d 887, 894 (10th Cir. 1991)). Accordingly, the issue of market power is often litigated and difficult to prove. LePage's, Inc. v. 3M, 324 F.3d 141, 146 (3d Cir. 2003).

9. It is noteworthy that the over-deterrence and under-deterrence effects noted above do not cancel each other. This is because firms which are not in a monopolistic position are not subject to the monopolization prohibitions, even if they wrongly assume they enjoy such a position.

10. The doctrine of collateral estoppel might enable a subsequent plaintiff to rely on a previous court decision to prove the existence of a monopoly position. Nonetheless, as elaborated below, some of the doctrine's preconditions might limit its application. *See infra* notes 39-40.

the benefits of such separation are obvious, most notably the affirmation to competitors, suppliers, distributors and customers of the monopolist, as well as to the monopolist itself, of its legal status. This affirmation of status is important for increasing the incentives of market participants to take an active part in regulating the monopolist's actions, whether by lodging complaints to the antitrust authorities or by bringing private damage suits against it. It also reduces the incentives of monopolists to engage in abusive conduct, in the first place, by waving a "red flag" before them. These effects are exacerbated by the fact that oftentimes a course of conduct that is considered abusive by a monopolist is considered to be legal if engaged in by a non-monopolist,[11] so that differentiation between the two, without knowledge of market position, is very difficult. The proposed regulatory mechanism also increases the efficiency of the enforcement mechanism by increasing deterrence without necessarily increasing the level of actual enforcement. It also increases coherence of law enforcement.

The regulation-by-declaration mechanism provides a middle ground, a mixture of state regulation and private orderings.[12] This symbiosis is beneficial in achieving policy goals by creating enforcement tools that respond to the different motivations of different market participants: the monopolist, its rivals, suppliers, distributors and competitors. Central to the proposal is the participatory and competent monitoring and regulation of private actors. By strengthening the incentives of private parties to regulate the conduct of a monopolist, the proposed mechanism delegates a significant part of the task of monitoring abusive conduct to private parties. This, in turn, increases the effectiveness of private regulation of abusive conduct, as well as the incentives of the monopolist for self-regulation. The stronger private regulation, the more effective it is at securing compliance and the weaker the need to use more intrusive forms of government regulation. As Ayres and Braithwaite observe, such regulation enjoys the benefits of a higher degree of *laissez-faire* governance without abdicating

11. *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 4, at § 806e; HOVENKAMP, *supra* note 5, at 272.

12. For analysis of such mechanisms see, for example, IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE 3-4 (1992); David Levi-Faur, *The Global Diffusion of Regulatory Capitalism*, 598 ANNALS AM. ACAD. POL. & SOC. SCI. 12 (2005).

government's responsibility to correct market failure.[13] It may also be more efficient in the sense that a strategy based mostly on punishment wastes resources on litigation that would be better spent on monitoring and increasing the incentives for self-regulation. Both economic analysis and social analysis converge on the need to avoid policies of consistent reliance on punishment as a main tool for securing regulatory objectives, especially when self-regulation is a viable option.[14] Accordingly, the proposed regulation-by-declaration mechanism fits well with the growing literature on the delegation of regulatory powers to private enforcers, including the regulated body.[15]

At the same time, a stand-alone declaration of monopoly involves significant costs – most notably the costs involved in analyzing the market position of firms that might not, eventually, engage in abusive conduct. Accordingly, as this article suggests, the use of the regulation-by-declaration mechanism should be limited to specific types of cases, in which the benefits of such declarations are likely to outweigh their costs and in which the overall positive effects of the declaratory mechanism outweigh those of alternative regulatory strategies.

The article proceeds as follows. The first chapter describes, in detail, the suggested regulatory mechanism. The second chapter analyzes the welfare effects of such a mechanism, by focusing on its potential benefits and costs. The third chapter delineates those cases in which the declaratory mechanism can potentially increase social welfare. It is submitted that the benefits from an optimally designed declaration mechanism may well outweigh its costs.

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13. AYRES & BRAITHWAITE, *supra* note 12, at 3-4.

14. *Id.*

15. *See, e.g., id.*; David Levi-Faur, *Varieties of Regulatory Capitalism: Sectors and Nations in the Making of a New Global Order*, 20 GOVERNANCE (2006) (forthcoming); Levi-Faur, *supra* note 12, at 3-4 (part of what Regulatory Capitalism means is using markets as regulatory mechanisms, as opposed to the neoliberal schema of markets as the antithesis of regulation); CHRISTINE PARKER, THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY (2002); NEIL GUNNINGHAM & PETER N. GRABOSKY, SMART REGULATION: DESIGNING ENVIRONMENTAL POLICY (1998).

I.
DECLARATION AS A REGULATORY MECHANISM

This chapter describes the proposed regulatory mechanism in detail. As noted above, the main innovation of the proposition is that the finding of monopoly is separated from the finding of abuse. Therefore, a precondition for its application is the empowerment of a regulatory body to declare that a firm holds a monopolistic position in a defined market. Such a declaratory mechanism can be designed in many ways. Fortunately, however, the Israeli Competition Act includes a declaratory mechanism. It is a good benchmark to use, as its design is quite efficient in most aspects, and thus will be described in detail.[16]

Under Israeli law, the Director of the Competition Authority ("the Director") may, upon his own initiative, declare a firm a monopoly if it meets the legal definition of monopoly.[17] The Declaration is a stand-alone procedure which can be performed regardless of whether or not it serves as a basis for the prosecution of allegedly abusive conduct. In order to perform his regulatory task, the Director is empowered to mandate the monopolist, as well as other firms operating in the market, to provide him with the relevant information required to analyze the market position of the potential monopolist.[18] Once a monopoly position is found to exist, the Director issues a Declaration, which declares the relevant firm a monopoly in a defined

16. For an economic and empirical analysis of the Israeli mechanism see Michal S. Gal & Amir Israeli, *Tying a bell around the Cat's Neck: Monopoly Declarations under the Israeli Law* (Haifa University Faculty of Law Working Paper, 2005) (on file with author). Some countries, such as Armenia and Azerbaijan, have a Register of Dominant Firms. Once a firm is found to be dominant and listed in the Register, it is required to send information on its activities on a regular basis to the agency. Law on the Protection of Economic Competition, Art. 18 (2000) (Republic of Armenia); Law of the Azerbaijan Republic About Antimonopoly Activity, Art. 16(2) (1996) (Azerbaijan), Somewhat similarly, Part IIIA of the Australian Trade Practices Act 1974 includes a mechanism which enables a service to be declared essential.

17. Restrictive Trade Practices Act, 5748 – 1988, § 26(A) (1988) (Isr.). Private parties may also request the Director is initiate declaratory proceedings, but the decision whether to do so remains the Director's and is subject to judicial review.

18. *Id.* at § 46(A).

market. The Declaration is published in the public records and is notified to the declared firm.[19]

The declared firm has thirty days to appeal the Declaration to the Antitrust Tribunal.[20] The Director must then bear the burden of proof that the Declaration is legally and factually founded. The Tribunal is empowered to review the declaration *de novo*, in light of new circumstances in the market at the time of the appeal, if market conditions have changed significantly after the Declaration was issued. The justification for such a rule is straightforward: as the Declaration is forward-looking, it serves little purpose to analyze and affirm a Declaration which should already be abolished.

The Declaration is declaratory in nature, rather than constitutive.[21] Accordingly, a firm might still be legally defined as a monopoly and be subject to the legal prohibitions that limit certain conduct by monopolists, even if it was not so declared. Moreover, a Declaration does not create a presumption of abuse.[22] It therefore does not change the substantive law with which a monopolist must comply. It does, however, change the procedural rules which apply.

The Declaration may be used as a rebuttable presumption of monopoly in any legal proceeding against the monopolist.[23] This means that the plaintiff does not have to prove that the defendant holds a monopolistic position in the relevant market, if he proves the existence of a Declaration. The burden of proof then shifts to the declared monopolist to prove that in actuality it does not possess such power. The stringency of the burden of proof is determined by the nature of the proceeding – criminal or civil, in accordance with usual evidentiary requirements. As will be elaborated below, the Declaration significantly reduces the costs borne by private plaintiffs bringing suit against a monopolist for abusive conduct. This raises

19. *Id.* at § 43.

20. *Id.* at §§ 28, 43. The Antitrust Tribunal is an administrative court, comprised of a District Court Judge and several lay members which represent the public interest. The Tribunal is empowered to hear certain types of antitrust cases, including appeals on decisions of the Director.

21. Bezeq v. Dir. of Competition Auth., Antitrust Tribunal, Appeal 7/95, 8 May 1997 (unreported).

22. Food Club Inc. v. Dir. of Competition Auth. et al., Antitrust Tribunal, Appeal 1/100, May 29, 2003 (unreported).

23. Restrictive Trade Practices Act, *supra* note 17, at § 43(E) & 26(A).

the following question: Why not strengthen the Declaration and create a non-rebuttable presumption of market power? The reason is two-fold. First, and most importantly, market conditions might have changed in the period relevant to the law suit, although the Declaration was not yet cancelled by the regulatory authority. A non-rebuttable presumption might thus impose a heavy burden on the authority to ensure that in any point in time the Declaration is accurate. Such a rule would significantly increase the costs involved in the declaratory process. Second, the monopolist should have his day in court to be able to rebut the Declaration. If the Declaration is non-rebuttable, then the monopolist will usually have no choice other than to appeal it once it is issued or once the facts on which it is based have changed, and to spend the necessary resources if there is a sufficiently high chance that the Declaration will be used as a basis for future lawsuits against it. The current mechanism allows the declared firm to postpone the decision of whether it would like to spend such resources to a future stage. Yet once the Tribunal rejects an appeal on the Declaration, the presumption it creates of monopoly power, at the time relevant to the appeal, is non-rebuttable, as the monopolist had its day in court.[24]

An important issue involves the Declaration's time span. In general, the Declaration applies until explicitly abolished either by the Director or by the Antitrust Tribunal.[25] Nonetheless, the Director might place a time limit on it, by specifying a date or a specific event, such as a reduction of quotas in a specific market or the entrance of a new competitor, after which it will be automatically voided. Periodic analyses of market conditions to verify whether the declared firm still holds a monopoly position should be performed by the declaring authority, to ensure that the Declaration does not mislead market participants or place unjustified burdens upon the declared firm.

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24. This results from the doctrine of *res judicata*. For the application of the doctrine in the antitrust context see AREEDA & HOVENKAMP, *supra* note 4, at § 318.

25. A court of law might also find that a defendant has rebutted the Declaration. Such a finding does not automatically abolish the Declaration, although future parties will not be able to rely on it before other courts if the doctrine of collateral estoppel applies. For some of the doctrine's limitations see *infra* notes 39-40.

It is noteworthy that the fact that the Director has not declared a firm a monopoly, has no evidentiary power. Therefore, a defendant cannot use this fact to defend himself against a claim that he holds a monopolistic position. This is an efficient rule, as it provides the Director with some flexibility with regard to the firms he chooses to declare. As elaborated below, such flexibility is vital for the declaratory mechanism to work efficiently.

Another issue concerns the regulatory body which should issue the Declaration. Under the current U.S. system, generally the courts determine whether a firm holds a monopolistic position.[26] One can ask whether they should continue to perform this task. The answer, I suggest, is negative. The antitrust agency is better placed to perform the declaratory task. The reason is three-fold.

First, the authority has the ability to gather the relevant information and to analyze it in order to make a decision on whether a declaration is justified. A court generally does not initiate regulatory proceedings and has limited tools to gather information on its own. Second, the antitrust agency usually has specific knowledge and past experience with many industries, which it can utilize in analyzing existing market conditions and in determining how regulatory funds are best spent.

Third, given that a Declaration might not be limited in time, the declaring agency must perform periodical reviews of whether the Declaration is still justified. A court is ill-suited for such a task. Thus, the declaratory function will best be placed upon the antitrust authority, while the court should be empowered to review such decisions. Such a review is important not just to ensure that the Declaration is factually based, but also to ensure that the agency, which is much more prone than the courts to regulatory capture and to political influences, was not affected in its decision by any irrelevant factors.

26. The Federal Trade Commission is also empowered to determine the existence of monopoly power in cases which come under its jurisdiction. The Federal Trade Commission Act, 15 U.S.C. § 45 (2000).

II.
EFFICIENCY ANALYSIS OF THE DECLARATORY MECHANISM

Regulation is justified only where it contributes to social welfare more than it harms it. The appropriateness of a particular regulatory mechanism is also contingent on the comparable effects of alternative regulatory tools. Therefore, this chapter analyzes the costs and benefits of the proposed regulatory mechanism, and attempts to determine whether there are cases in which the benefits outweigh the costs and in which the regulation-by-declaration mechanism is more efficient than existing regulatory mechanisms.

A. *Benefits*

1. *Red and Green Flag Effects*

Under the antitrust laws, monopoly, as such, is not prohibited. Rather, the monopolist is allowed to use its power to reap large economic benefits, as high profits are regarded as the carrot at the end of the stick of market competition.[27] At the same time, however, the monopolist is prohibited from abusing its market power in order to create artificial barriers to entry in its markets, which would reduce the ability or incentives of its competitors to enter or to expand in the market. Limiting such abuses is vital for the market mechanism to operate efficiently, as otherwise the monopolist's actions might prevent the dynamic process whereby more efficient firms replace less efficient incumbents and competitive pressures serve to reduce price and increase quality. Accordingly, abusive conduct is considered to be anti-competitive and may also

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27. Verizon Commc'n, Inc. v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398, 407 (2004)

> The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices - at least for a short period - is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.

See generally Michal S. Gal, *Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief About Monopoly?* 49 ANTITRUST BULLETIN 343 (2004).

serve as a basis for a damage suit, eligible for treble damages.[28] As this sub-chapter shows, the declaratory mechanism increases the incentives of declared monopolists to comply with the law and thus limits abusive conduct.

Nobel Laureate, economist Gary Becker, has shown that the incentives of market participants to engage in illegal activity are comprised of two main variables: the probability of conviction and the level of the expected sanction. The higher their combination, the weaker the incentive to engage in the illegal conduct in the first place.[29] This claim can be easily applied to abusive conduct. Assume that a monopolist considers whether to engage in abusive conduct that is expected to increase its revenues by one million dollars. Further assume that the sanction for such conduct, once legally proven to exist, is two million dollars. Although the sanction is much higher than the revenue, a rational monopolist which takes only direct economic considerations into account, will engage in abusive conduct unless it considers the probability of conviction to be 50% or higher (since in all other cases the expected costs, which are two million dollars at 49.9% or lower, are lower than the expected gain of one million dollars, and therefore the expected utility from the abusive conduct is positive). Thus, the higher we increase the probability of conviction, the better we deter abusive conduct.

The Declaration increases the probability of conviction of abusive conduct in three interconnected ways. First, it increases the probability that the regulatory authority will monitor the declared monopolist's conduct more closely, now that its market position is known. Such close monitoring can lead, of course, to a higher detection rate of abusive conduct.

Second, and more importantly, by reducing the uncertainty surrounding a would-be monopolist's market position, the declaratory mechanism increases the incentives of private parties to investigate allegedly anti-competitive conduct, to notify it to the authorities and to take private action against it. The declaration creates a "green flag," a go-ahead effect, to market participants – suppliers, distributors, consumers or

28. Sherman Act, 15 U.S.C. § 2; Clayton Act, 15 U.S.C. §§ 14 and 15(a) (2000).

29. Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

competitors of the monopoly – for private monitoring and regulation. Private parties will spend resources on monitoring the conduct of other firms and taking action against it only if their private gains from such behavior are larger than their expected costs. When monitoring, notification and regulation costs are low, the Declaration has no significant effect on the incentives of private parties to act as private regulators. However, when such costs are high, private parties will invest in them only if the probability that their actions will eventually lead to the prevention of the abusive conduct or to a successful and cost-justified damage suit are sufficiently high. The Declaration significantly increases the chances that private investigations will not be wasteful, as it increases the chances that the precondition for limiting such conduct will be met and that if abusive conduct is found, it will be prohibited. Given the difficulties involved in determining whether a firm holds a monopoly position in the market, which are analyzed below, this effect is highly important.

Thirdly, and a further expansion of the previous effect, the fact that the Declaration can be used as proof of monopoly further increases the incentives for bringing private suits against the monopolist. As noted above, proof of monopoly is the entry gate to every private monopolization suit. The Declaration eases the entry through that gate as it serves as a rebuttable presumption for the existence of monopoly in any legal proceeding. The practical effects of this legal presumption are a reduction in the costs and an increase in the chances of success of a private suit. Take, for example, a case of abuse of market power that created damages for consumers in the amount of one million dollars. Further assume that the chances of proving the abuse are 80%, and the costs of proving it are 500,000. If the plaintiffs believe there is a 80% chance that a court might find a position of dominance, but proving it might cost them $200,000, then they would not bring the case at all, although the monopoly has abused its power and has greatly benefited from it (expected costs of $500,000 plus $200,000 are smaller than expected benefits of $640,000 (one million dollars multiplied by the chances of proving an abuse (80%) and additionally by the chances of proving a dominant position (80%))). If a Declaration existed, the costs of proof of monopoly would be significantly reduced (the plaintiff has only to rebut the rebuttal) and the

chances of success significantly increased, and thus the incentives for bringing private action against the monopolist would also be increased.[30]

Accordingly, the higher the uncertainty of whether a firm holds a monopoly position and the higher the costs and the lower the probability of proving such a position, the less effective are the regulatory tools that depend on such a proof. This effect is further strengthened by the fact that many of the business practices that are considered to be abusive when engaged in by a monopolist, are regularly adopted by non-monopolistic firms. The law prohibits the former and allows the latter, due to their divergent effects on market conditions. Accordingly, market participants may observe similar types of conduct, but without knowing whether the firm possesses market power, their incentives to report it to the government or take any other action against it are significantly reduced.

The regulation-by-declaration mechanism also creates a "red flag" effect on the declared monopolist.[31] By increasing the probability of detection of abusive conduct in the three interconnected ways specified above, the monopolist's incentives for self-regulation are strengthened.

The proposed regulatory mechanism further increases self-regulation by building upon the incentives of at least some monopolists to comply with the law, once there is a sufficiently high degree of certainty that it applies to them. Some corporate actors are deterred not only by economic losses but also by reputational losses resulting from adverse publicity.[32] In addition, as some researches have argued, some corporate ac-

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30. This example assumes that no treble damages are recoverable. However, it can easily be shown that even when such damages are payable, the cost of proving a monopolistic position, especially where the chances of success are not 100%, can outweigh the benefits of many private suits.

31. This effect is illustrated, *inter alia*, by the appeal brought by Coca Cola against the EC Commission on its decision that Coca Cola holds a dominant position in the relevant Market, albeit it did not find that it abused its power. The Court of First Instance recognized that: "A mere finding of a dominant position by the Commission [is] likely in practice to influence the policy and future commercial strategy of the undertaking concerned." Coca-Cola v. Comm'n, T-125/97 & T-127/97 (1997), *available at* http://europa.eu.int/eurlex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61997A0125:EN:HTML

32. *See generally*, Brent FISSE & JOHN BRAITHWAITE, THE IMPACT OF PUBLICITY ON CORPORATE OFFENDERS (1983). *See also* Oren Bar-Gill & Alon Harel,

tors are also often concerned to do what is right, within the limits of the law, in order to sustain a self-concept of social responsibility.[33] As Ayres and Braithwaite suggest, to adopt punishment as a strategy of first choice under such conditions is counterproductive and inefficient as it does not take advantage of the good will of those with a commitment to compliance.[34] If an actor is motivated by social responsibility goals, then persuasion rather than punishment is the best strategy to further cultivate this motivation. Thus, a mix of cooperation and punishment might be preferable to punishment alone, especially where the precondition for the application of the law is complex and hard to apply. The regulation-by-declaration mechanism achieves this goal by waiving a red flag in front of the monopolist that the preconditions for the application of the monopolization provisions are met, without creating a negative stigma. Rather, the Declaration increases the certainty of one's market position and the fact that he is subject to the monopolization prohibitions. Accordingly, it lends authoritative support to law-abiding constituencies, thereby increasing their self-regulating motivations.

The strength of the green and red flag effects of the Declaration depend on the costs and difficulties involved in defining a firm as a monopoly.[35] If market participants, including

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Crime Rates and Expected Sanctions: The Economics of Deterrence Revisited, 30 J. LEGAL STUD. 485 (2001).

33. *See generally*, Peter C. Yeager, *Understanding Corporate Lawbreaking: Progress and Prospects*, in INTERNATIONAL HANDBOOK OF WHITE-COLLAR CRIME (Henry N. Pontell & Gilbert L. Geis eds., forthcoming 2006); JOHN BRAITHWAITE, RESTORATIVE JUSTICE AND RESPONSIVE REGULATION (2002); ANDREW HOFFMAN, FROM HERESY TO DOGMA: AN INSTITUTIONAL HISTORY OF CORPORATE ENVIRONMENTALISM (2001); Peter C. Yeager, *Management, Morality and Law: Organizational Forms and Ethical Deliberations*, *in* CORPORATE CRIME: CONTEMPORARY DEBATES (Franklin Pearce and Laureen Snider eds., 1995).

34. AYRES & BRAITHWAITE, *supra* note 12, at 26; EUGENE BARDACH & ROBERT A. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS 105-06 (1982) (noting that when firms with good compliance records inadvertently violate regulations because rules are complex or ambiguous, managers are likely to regard punishment as unwarranted and unfair).

35. Such incentives are also affected by the breadth of the prohibitions as well as the level of certainty. This article assumes that both factors are given. Nonetheless, as elaborated below, in a world of limited resources, when the scope of a given prohibition is largely uncertain, it might be more efficient

the monopolist, are quite certain of the relevant firm's monopolistic market position, even without an official declaration, and all assume it would be easy to prove such a position, then the red and green flag effects are small. If, on the other hand, market participants are unclear about the legal status of a dominant firm and the costs of investigating and proving such a position are high, then the red and green effects are much more pronounced. Such costs can be significant for several reasons.

First, market participants, as well as the monopolist, need to determine the scope of the relevant market and whether the declared firm holds a monopoly position in it.[36] Such analysis oftentimes involves complicated legal, economic and factual issues. Private plaintiffs, as well as would-be monopolists, oftentimes do not have the analytical skills to perform the required analysis. Thus, the Declaration is of significant practical value.

Second, the declaratory mechanism enables private parties to overcome obstacles to access to the factual evidence necessary to prove the existence of a monopoly. This is because the regulatory authority has much more powerful investigatory powers than a private party. For example, it can mandate the relevant firm, as well as other market participants, to disclose information regarding the relevant market, such as sales figures, expansion plans and existing entry barriers. In addition, the regulatory authority might also have much more knowledge of the specific industry than small market participants. While private parties might also be able to obtain at least some of the relevant information, this task might be more costly and much less accurate if performed by them. Even if private parties are granted access to information in the discovery process as part of a law suit, such discovery takes place only after the plaintiff established a plausible case for the existence of market power.[37] Also, relevant documents can be regularly obtained by private parties only from the defendant and not

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to invest in determining the scope of such a prohibition, rather than in increasing certainty of a monopoly.

36. "In a typical section 2 case, monopoly power is 'inferred from a firm's possession of a dominant share of a relevant market that is protected by entry barriers.'" United States v. Microsoft Corp., 253 F.3d 34, 51 (D.C. Cir. 2001), *cert denied*, 122 S. Ct. 350 (2001).

37. *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 4, at § 307.

from other market participants, and such documents might not be sufficient to establish its market position. Therefore, the declaratory mechanism enables the plaintiff to overcome the evidentiary obstacles involved in the proof of a monopoly position.

Finally, the declaration relieves private plaintiffs from the need to invest large resources in order to prove the existence of a monopoly. To be sure, the monopolist can still argue that it did not possess monopoly power at the time relevant to the lawsuit, as the Declaration creates only a rebuttable presumption that monopoly power actually exists. This implies that not all costs of proving monopoly would be eliminated, but costs will certainly be reduced. This benefit is especially important if several private plaintiffs, which bring separate private suits, each have to prove the existence of a monopoly position.[38] In such a situation the Declaration prevents duplicative investments. Duplicative costs may also be reduced when the doctrine of collateral estoppel can be applied, to prevent relitigation of a legal finding.[39] Yet to apply, the period in which the defendant was found to have monopoly power in the prior judicial decision must include that which is relevant to the new suit.[40] Also, the prior suit must have created a comparable risk to the defendant relative to the one created by the new suit.[41] Given these limitations, the doctrine might not apply in all cases. Moreover, litigation might be necessary to decide if a previous decision on the issue is binding. In addition, the declaratory mechanism is likely to reduce erroneous findings, as the decision is made by a specialized agency rather than a lay

38. As Tineo and Pittman have shown, a large percentage of abuse of dominance cases in Latin America are brought against regulated entities, such electricity and water companies. In such cases the declaration might serve an important function in reducing enforcement costs. Maria Coppola Tineo and Russell Pittman, *Abuse of Dominance Enforcement Under Latin-American Competition Laws* (Working Paper, 2006), *available at* http://ssrn.com/abstract=888186.

39. RESTATEMENT (SECOND) OF JUDGMENTS §§ 27-28 (1982). The Supreme Court approved offensive collateral estoppel in *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979). For non-mutual offensive collateral estoppel in antitrust cases see AREEDA & HOVENKAMP, *supra* note 4, at § 318.

40. This is a direct result from the condition that the fact to be precluded must be essentially identical to the issue or fact decided in the original suit. United States v. Head, 697 F2d 1200 (4th Cir. 1982).

41. Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979).

court. The Declaration might thus still be preferable to the doctrine of collateral estoppel, at least in some situations.

To sum up the benefits of the Declaration explored so far, it increases the deterrence effects of the monopolization prohibitions without necessarily increasing enforcement costs. The Declaration increases the incentives of market participants to invest in monitoring the monopolist's conduct by increasing the chances that legal proceedings to limit abusive conduct or to recover damages resulting from it will be successful. This effect increases the monopolist's incentives for self-regulation. Such motivations are further increased by the incentives of at least some monopolists to comply with the law.

2. *Increasing Coherency*

An additional benefit of the declaratory mechanism is the creation of a coherent body of law on the analysis of monopoly position, which would then reduce uncertainty and increase fairness by way of similar application of the law. Without the Declaration, monopoly power issues would be analyzed and decided by different courts, in accordance with jurisdictional rules. The outcome will then depend on the analytical skills of different courts, as well as the ability and skills of the parties to the judicial proceeding in presenting the relevant facts before the court, which may differ significantly. The declaratory mechanism limits this problem by concentrating the analysis of many monopoly determinations in the hands of one body. In addition, the possibility of false positive and false negative errors is reduced since the decision is made by a regulatory body which possesses the skills and the tools necessary to gather the relevant information and to perform the required analysis.

To increase coherency further, it is suggested that all appeals on declaratory decisions by the regulatory authority be heard before a designated court. While the existence of a monopoly position might still have to be determined by a regular court if a monopolist attempts to rebut the presumption created by the Declaration, such a court will have the analysis of the regulatory authority before it, to assist it in analyzing the relevant issues.

B. *Possible Costs*

1. *Direct Costs*

Despite its apparent benefits, the declaratory mechanism entails a large price tag. Its main costs are, of course, the costs incurred by the regulatory authority in the process of obtaining the relevant information, analyzing it, declaring a monopoly and, if necessary, defending the Declaration in court. Such costs might be significant as in most cases it is not a simple task to determine whether a firm holds a monopoly position. Once a firm is declared a monopoly, the authority bears the additional costs of periodically analyzing the relevant market conditions, to ensure that the Declaration is still justified. Such costs might be significant when market conditions constantly change. Additional direct costs are incurred by the declared monopolist in appealing the Declaration in court and by the courts before which the appeal is heard.

Yet such costs should not be considered a waste if costs of proof of a monopoly position would be incurred anyway, by the government or a private party, as a basis for a legal proceeding alleging anti-competitive conduct. In fact, it might be less costly for the agency to prove the existence of a monopoly rather than for a private plaintiff, given the agency's expertise and the evidentiary tools at its disposal. Such costs would also not be wasteful if the Declaration's green and red flag effects would deter the monopolist from engaging in socially-harmful abusive conduct in the first place.

Nonetheless, the Declaration might still be wasteful in two main situations. First, it might be that although a firm enjoys market power, it will not abuse it anyway. In such a case, proof of monopoly power is wasteful. Unfortunately, however, the probability of this occurrence is difficult to calculate. The fact that a firm is declared a monopoly and never sued for abuse is no indicator that the costs of the Declaration were wasteful. Rather, it might well be that the Declaration induced self-regulation by the monopolist. A study conducted on declared monopolies in Israel has revealed that a large percentage (70%) adopted internal measures to ensure a higher degree of compliance with the antitrust prohibitions and most of the private and governmental suits brought against monopolists involved firms which were not declared as such (83.5%). These facts

indicate, albeit crudely, that the Declaration does have some red flag effect.[42]

Second, the declaration might be wasteful if the potential for social harm by the declared firm is lower than the costs of the Declaration. Assume that a firm holds a monopolistic position in a relatively small market, and thus the potential negative welfare effects of its abusive conduct are $100,000. Further assume that the costs of declaring the firm a monopoly are $150,000, given the evidentiary and legal difficulties that must be overcome. In such a situation declaring a firm a monopoly would be socially wasteful. Moreover, the antitrust authorities operate, like any other regulatory body, with limited resources. Should the authority invest resources in declaring firms monopolies when the costs of such a declaration outweigh its benefits, it would have less resources for its additional regulatory tasks, including the regulation of known monopolies.[43]

2. *Indirect Costs*

An erroneous Declaration sends a wrong signal to market participants. It creates over-deterrence effects on the declared firm and it unjustifiably increases the motivations of private firms to monitor and bring actions against the declared firm. An erroneous Declaration might result from a flawed factual or legal analysis by the regulatory authority. Alternatively, it might result from a change in market conditions that should have resulted in the abolishment of the Declaration, but did not. In dynamic markets the position of market players might significantly change over a short period of time, due to

42. Gal & Israeli, *supra* note 16.

43. Nicholson and Melikyan argue that this is the situation in Armenia, where many scarce resources are spent on debates of whether a specific firm should be listed in the Register of Dominant Firms, instead of spending the resources in finding abuses of monopoly power. Michael Nicholson & Lilit V. Melikyanl, *A Critical Analysis of the Competition Law in Armenia* (Working Paper, 2004), *available at* www.joensuu.fi/taloustieteet/ott/scandale/tarto/papers/Lilit%20Melkyan.pdf. In Armenia the problem is exacerbated by the fact that the threshold for registration is very low (a 33.3% market share). Indeed, where the prohibition of monopolization is yet unclear, it may not be welfare-enhancing to spend much of the scarce enforcement resources on declaring monopolies. It is also noteworthy that in countries in which institutions are corrupt, a system of public registry might trigger attempts by dominant firms to stay off the list.

changes in market conditions such as the introduction of new technology or the entrance of new aggressive rivals. A firm holding a monopolistic position at the time of the Declaration might thus not hold such a position at the time when abusive conduct is alleged. An erroneous Declaration is especially problematic when another firm possesses monopoly power in the market, but the Declaration creates a legal presumption that the declared firm holds such a position. Yet the occurrence of such situations is limited by several factors. First, the declaratory mechanism is performed by a regulatory agency which specializes in the analysis of market conditions. Second, the Declaration is subject to judicial review. Third, the declared firm has strong motivations to challenge an erroneous Declaration and to monitor and report any changes in market structure to the regulatory agency and, if needed, challenge it on appeal.

It is noteworthy that in some situations the Declaration itself might harm competition. The reason is that the Declaration, which provides the monopolist with an official recognition of the fact that most consumers prefer its product or service over its rivals', might be used by the monopolist as a basis for a campaign to increase its market power even further. Accordingly, the Declaration might harm competition by creating or increasing entry barriers into the market. Such entry barriers might be significant in markets in which consumers do not possess perfect information on the characteristics of the competing products, and they rely on the past choices of other consumers in making their own decisions, or where the product is characterized by network effects (such as cellular phones and computer operating systems) and consumers recognize the inherent benefits of choosing the same product chosen by the largest number of consumers. Yet these effects might not necessarily always be socially harmful, as they reduce search costs for consumers and increase positive network effects.

3. *Increased Enforcement in Conditions of Uncertainty*

Another possible cost of the Declaration is the increase in the level of deterrence where uncertainty regarding the scope of the legal prohibitions is present, which might create over-

deterrence.[44] As noted above, the incentives of a monopolist to engage in anti-competitive conduct are affected by the level of enforcement and the height of the expected sanction. The Declaratory mechanism increases the level of deterrence by increasing the probability of enforcement if the monopolist engages in anti-competitive conduct. In most cases an increase in the level of deterrence is socially beneficial.[45] However, once legal uncertainty enters the equation, the optimal policy might change. When the boundaries of the prohibited conduct are not clear, more enforcement, and especially more self-enforcement, might be harmful.

Some parts of the monopolization prohibition are a relatively uncertain areas of law. The offense is characterized by open-ended legal standards that allow antitrust courts and enforcement agencies to exercise wide discretion in interpreting and applying them. While its core concepts are relatively settled, in some cases it does not provide *ex ante* definitive legal guidelines, despite being part of the antitrust milieu for more than a century. Rather, it provides market participants with unclear criteria regarding the boundaries of the offense.[46] The source of uncertainty is the reliance on legal standards rather than rules, coupled with the fact that the legality of conduct is informed, to a large degree, by economic teachings, that may evolve over time and that are oftentimes heavily fact-dependent. Consider, for example, the issue of whether and under which circumstances tying is anti-competitive. There has been a significant shift in economic and legal commentary on this issue in the past decade from *per se* legality to a rule of

44. Such an over-deterrence effect will be especially pronounced where damages for monopolization are multiplied, as in the case of U.S. treble damages.

45. Becker, *supra* note 29.

46. *See* United States v. Microsoft Corp., 253 F.3d 34, 44-45 (D.C. Cir. 2001), *cert. denied*, 122 S. Ct. 350 (2001) Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad. The challenge for an antitrust court lies in stating a general rule for distinguishing between exclusionary acts, which reduce social welfare, and competitive acts, which increase it. From a century of case law on monopolization under § 2, however, several principles do emerge.

reason analysis.[47] Yet market participants may be found liable under the antitrust laws, as long as the restraint of trade is a natural consequence of their business arrangements.[48]

The facts just described bear on the optimal choice of rules to deter anti-competitive conduct. When the law is indeterminate, false positive and false negative errors by courts may occur more frequently. False positive errors impose two main costs. The direct costs of such errors are the costs of the sanction and of the faulty judicial process.[49] Uncertainty further increases the costs of the judicial process because actions might be brought more frequently and because the judicial process is necessarily longer and more complex than when the law is certain.

The indirect cost of false positive errors is the "chilling" of future competitive behavior.[50] Individuals would, on account of possible court errors, be more likely to exercise excessive cautiousness in business decision-making and be deterred from committing harmless acts that nonetheless subject them to the risk of sanctions. The social cost of these effects are individuals' private valuation of the acts deterred as well as any positive externalities of the conduct prevented (e.g. overcoming information asymmetries).

Accordingly, where uncertainty is high, increased enforcement is not necessarily beneficial.[51] Increased enforcement in

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47. Illinois Tool Works Inc., et al. v. Indep. Ink, Inc., 126 S. Ct. 1281, 1283 (2006) ("Over the years, this Court's strong disapproval of tying arrangements has substantially diminished, as the Court has moved from relying on assumptions to requiring a showing of market power in the tying product.")

48. Conduct that comes under the scope of the monopolization offense does not require specific intent to restrain trade. It is sufficient that a restraint of trade results as the natural consequence of a conduct or a business arrangement. United States v. Griffith, 334 U.S. 100, 105 (1948); *See* Aspen Skiing Co. v. Aspen Highlands Skiing Co., 472 U.S. 585, 602 (1985); AREEDA & HOVENKAMP, *supra* note 4, at § 651.

49. When sanctions are monetary and individuals are risk-neutral, economic analysis treats sanctions as socially costless, as pure monetary transfers between individuals. When individuals are risk-averse, the riskiness of sanctions is in itself a cost. *See* Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307, 347 (1994).

50. *See id.* at 386.

51. For an argument along the same lines see Louis Kaplow's argument that when the probability of legal error is greater, an enforcement policy that relies on higher rather than lower sanctions may be appropriate. In

such conditions is especially problematic where self-regulation is increased, since in such cases even the benefit from increased enforcement of the accumulation of legal precedents to clarify the law is not achieved.[52]

Yet the height of such costs is determined by the level of uncertainty of the prohibition. Where the monopolist engages in conduct that is clearly abusive, such costs are not incurred and increased enforcement serves social welfare. In addition, the regulation-by-declaration mechanism also reduces total sanctions imposed in practice, as it increases the incentives for self-regulation. As sanctions for antitrust violations are quite high – private plaintiffs may be awarded triple damages – self-regulation reduces the occurrence of such high sanctions.

III.
CRITERIA FOR MONOPOLY DECLARATION

As was shown, the declaratory mechanism creates costs as well as benefits. This sub-chapter attempts to determine in which cases the benefits of the Declaration justify its use. The analysis is based on the assumption that the regulatory authority enjoys some discretion with regards to the decision of whether or not to investigate and to declare a firm a monopoly. Such discretion enables the authority to wisely spend its resources in order to best achieve its regulatory goals. At the same time, as elaborated above, in order to reduce improper influences on an administrative body, the decisions are subject to judicial review.

In a world with unlimited resources, it might have been wise to declare all monopolists as such, where there exists a high degree of certainty as to their market position and to monitor their market positions frequently. However, as resources are limited, it is suggested that the authority engage in

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achieving a given level of deterrence, higher sanctions permit enforcement efforts to be reduced, with the result that sanctions are mistakenly imposed less often. *Id.* at 388.

52. To be sure, the accumulation of precedents does not necessarily eliminate uncertainty. William M.Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249, 250 (1976). Complex factual settings or changing trends of economic analysis of market conduct may create new uncertainties. Yet prior decisions may serve to eliminate at least some uncertainties that arise in a wide range of cases.

a thorough analysis of a would-be monopolist's market position only when a *prima facie* analysis of the situation indicates that the Declaration is cost justified. The test should focus not only on the immediate effects of the Declaration on market participants, but also on the probable future market position and conduct of an existing monopolist, as well as on its effects on the regulatory milieu of the authority.

Accordingly, the regulatory authority should consider, *inter alia*, the following parameters in determining whether to use its declaratory power. First, it should consider the size and the probability of the potential harm of abusive conduct engaged in by the relevant firm. Where such harm is small relative to the costs of the Declaration, the declaratory mechanism should not be used. This is because dominance does not necessarily imply significant harm on any absolute scale. Assume that a firm is the only provider of hairdressing services for men in a small town. Also assume that most consumers will not travel out of town to get their hair cut, and they are so afraid that their spouses will cut off a piece of their ear, that home styling is not an option. The hairdresser clearly holds a dominant position in the relevant market and thus meets the legal requirements for declaring it a monopoly. However, it might not make much economic sense for the regulatory authority to spend its resources to declare the hairdresser a monopoly. This is because the harm caused by the dominant firm is predictably very small in absolute terms, relative to the costs of the Declaration.

Second, the regulator should consider the level of certainty which exists with regard to the market position of the relevant firm, and the difficulties involved in proving such a position by private parties. If it is relatively easy to determine the legal status of the monopolist, then the need for a Declaration is reduced. If, however, there is a high level of uncertainty that limits private regulation and limits the incentives of the monopolist to comply with the law, then the need for a Declaration is increased. One of the parameters that affects this analysis is the level of sophistication of market participants. The higher it is, the more limited the justification for a Declaration. Another relevant parameter is the cost of such proof. It might well be that a monopoly position is assumed to exist by market participants, but the costs of proving its exis-

tence are prohibitively high. The higher the costs, the stronger the justification for a Declaration.

Third, the regulator should also consider the degree of dynamics in the relevant market. For example, if a market is currently characterized by high entry barriers, which enable the exercise of market power, but there is a high possibility that entry barriers will be significantly reduced in the near future due to a major change in market conditions, then there is not much justification in spending the funds necessary to declare a monopoly.

Fourth, the regulatory authority should also consider the relative benefits from alternative use of its resources for other regulatory tasks. The higher such benefits, the weaker the justification for a Declaration.

Finally, the social value of the Declaration is also dependent on the ability to prove abuse. The more difficult and costly it is to prove abuse, the higher the probability that the Declaration would be wasteful. The reason is that the Declaration does not serve any purpose on its own. Rather, it is used to reduce the difficulties of proving the first condition in an abuse case and for increasing the self-regulation function of the monopolist. Thus, it would only be justified where the costs of proving possible abuse are not prohibitive.

IV.
CONCLUSION

As several scholars have already shown, sound regulation is often a mixture of both government regulation and private ordering. Such a mixture can create an efficient symbiosis that harnesses the incentives of private parties to establish better enforcement tools. This article proposes such a symbiosis. The regulation-by-declaration mechanism proposed and analyzed in this article integrates the strengths of both private and public regulation in order to limit abuses of monopoly power.

If one accepts the proposition that private regulation is efficient in that it increases the level of deterrence of abusive conduct and thus reduces the incentives of monopolists to engage in such conduct in the first place, then increasing the incentives of private parties to engage in such regulation further, might increase social welfare. The declaratory mechanism does exactly that: it increases the regulatory incentives of

private parties. The mechanism is quite simple: it separates the two stages of abuse regulation by empowering the antitrust authority to issue a stand-alone declaration that a specific firm holds a monopoly position in a specified market. The Declaration is then communicated to both the declared firm and to the public, and also creates a rebuttable presumption of monopoly in any legal proceedings against the declared firm, whether brought by the government or by private parties. As elaborated above, this separation increases the regulatory incentives of private parties: By increasing the certainty that a firm holds a monopoly position, it increases the probability that abusive conduct – if detected – will be prohibited and might be used as a basis for a damage suit. It further increases monitoring and regulatory incentives by reducing the direct costs and by increasing the probability of success of proving a monopoly position.

The declaratory mechanism also provides the dominant firm with a constant reminder that its conduct is under surveillance thereby increasing its incentives for self-regulation. By increasing the level of enforcement without creating, by itself, a negative stigma, the mechanism further harnesses the motivations of law-abiding constituencies to further increase their self-regulating motivations. It may also increase the predictability of the legal status of the firm's actions, especially when the same conduct which is considered abusive if engaged in by a monopolist is legal when engaged in by a non-monopolist, thereby reducing the over-deterrence effects of the law. Further benefits include increased coherency in the interpretation and the application of the law.

Yet a stand-alone declaration of monopoly involves significant costs. Accordingly, this article suggests that the regulation by declaration mechanism should be used only in specific types of cases, elaborated in the article, in which the benefits of such declarations are likely to outweigh their costs and in which the overall positive effects of the declaratory mechanism outweigh those of alternative regulatory strategies. In such cases, the proposed mechanism may well provide a means to tie the bell around the cat's neck.