Antitrust and Professional Rules: A Framework for Analysis

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I. INTRODUCTION

To be a professional society is to have rules.[1] What distinguishes a group of professionals from mere purveyors, merchants, and

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1. *See, e.g.*, W. MOORE, THE PROFESSIONS: ROLES AND RULES 117 (1970) (Codes of conduct "are an almost universal feature of professional and quasi-professional

tradespeople is a perception among the group, which can be exported to consumers of their services, that they adhere to standards of admission and behavior that somehow separate them from non-professionals. At the least, a professional association would like to believe that its members conform to some norms that set them apart from others.

Two still recent strains in the evolving economic analysis of behavior bear upon the proper approach to professional rules. They not only bear upon it, they run head long into each other. First, the firmly established economic capture theory of regulation posits that government regulation is a good that is provided in accordance with the fundamental laws of supply and demand.[2] A group of suppliers, including suppliers of professional services, may attempt to obtain regulation from the government to serve their economic interests at the expense of others, usually consumers. An extension of this theory is that subgroups of suppliers may demand regulation that benefits them at the expense of other suppliers, as well as consumers.

The capture theory began as an explanation of government action, whereas professional codes can be adopted by private associations. However, public and private action tend to blend in the realm of ethical norms. A code may begin as the child of an association and be adopted by a government entity, thereafter claiming legitimacy from both sources and growing old under the influence of both. Indeed, professional societies sometimes attempt to attract members by stressing that they lobby government officials for regulation favorable to the profession.[3] In the last few years, some scholars have advanced the idea that suppliers of a product or service can act privately to raise the costs of supply to increase their rents at the expense of consumers.[4] This theory does not depend upon government action, and given the right circumstances, a professional code can be explained as a device manipulated to achieve the desired result.

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associations").

2. *See generally* Stigler, THE THEORY OF ECONOMIC REGULATION, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667 (1975); Peltzman, *Toward a More General Theory of Regulation*, 19 J. L. & ECON. 211 (1976). The possibility of economic capture has led one commentator to suggest a state action doctrine of antitrust immunity that distinguishes between anticompetitive state acts that are the product of capture and those that are not. *See* Wiley, *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986).

3. On the evolution of lobbying efforts by professional associations, *see* C. GILB, HIDDEN HIERARCHIES: THE PROFESSIONS AND GOVERNMENT 143-51 (1966).

4. *See, e.g.*, Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986) [hereinafter Krattenmaker & Salop, *Anticompetitive Exclusion*].

The economic capture theory fits snugly, both historically and conceptually, into a legal and economic tradition that was hostile to horizontal agreements,[5] even if it fits into other traditions as well. The classic manifestation of that tradition was Adam Smith's paranoia over intercourse among competitors, even meetings for "merriment and diversion."[6] Someone suspicious of all horizontal cooperation and particularly that supported by government regulation is likely to view codes of professional associations as an inviting antitrust target.

However, professional rules may also be considered in light of the economic theory of property rights, a theory that is as well respected among proponents of economic analysis as is the capture theory.[7] The property theory rests on the premise that social value can increase through private investment. However, the investment will not be made unless investors can expect to recoup their economic costs, which means appropriating at least some of the enhanced value. In short, investors have to suppress rampant free riding. In theory, investors could agree with all potential free riders that they will not free ride, and to the extent the agreements are enforceable, obtain a sufficient measure of private security. But the transaction costs associated with a contractual approach to property rights are likely to make such a strategy economically unfeasible. Hence, the state steps in to define property rights when externalities frustrate value maximizing investments and cannot efficiently be eliminated through private arrangements.

Thus, the economic essence of a property system is to induce value-increasing investments by discouraging free riding. Professionals may invest in cultivating a demand for their services by increasing at least the perceived quality of those services. When information is costly to acquire, some professionals may be able to appropriate the value of the enhanced demand without providing the quality of services that generated the greater demand. In the long run, all of the members of the profession as well as consumers will suffer as the value of the services erodes. A code of ethics may represent a private

5. For references to manifestations of the "inhospitality tradition of antitrust," a phrase attributed to Donald Turner, *see* Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 4 (1984).

6. A. SMITH, THE WEALTH OF NATIONS 128 (Modern Library 1937) ("People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in . . . some contrivance to raise prices.").

7. *See generally* R. POSNER, ECONOMIC ANALYSIS OF LAW 29-75 (3rd ed. 1986); ECONOMIC FOUNDATIONS OF PROPERTY LAW (B. Ackerman ed. 1975); R. COOTER & T. ULEN, LAW AND ECONOMICS 88-210 (1988); De Alessi, *The Economics of Property Rights: A Review of the Evidence*, 2 RES. L. & ECON. 1 (1980).

agreement among professionals that they will not free ride on each other's investments in increasing the value of their services. If the value lost on account of free riding is not sufficient to justify the administrative cost of the state defining property rights, a private arrangement may be the only efficient method of stimulating productive investments.

The fact that the association may enlist the aid of the state, perhaps by persuading the government to adopt its code as a regulatory scheme, does not necessarily mean that the association is attempting to secure anticompetitive rents. A code that enhances efficiency as a private response to free riding still needs to be enforced. A professional society may want to avoid the private costs of enforcement by persuading the government to assume those costs. Moreover, the power of a private association to prevent free riding is limited. If a member violates an ethical rule, he or she may be expelled. However, if membership signals quality, non-members who do not invest in providing services of the same quality will have an incentive to pass themselves off as members. To the extent that identifying membership is costly for consumers, non-members may be able to free ride on the investments of members, and increase the association's costs of educating consumers. After all, the association cannot expel someone who does not belong to it.

Therefore, the association may turn to the state to suppress free riding more effectively than it can. One method of protecting members' investments is to have the state protect the association's trademark. The efficacy of this approach depends upon consumer recognition of the trademark and their willingness to distinguish between "certified" and "uncertified" professionals. This approach also, at least partially, depends upon the investment the association makes in promoting the trademark.

Another way the state might suppress free riding is to force all suppliers to provide high quality services. Of course, to the extent that low quality service substitutes for high quality service, the demand for high quality service and the profits of high quality providers will increase if low quality service is eliminated. Therefore, an association's attempt to persuade the state to eliminate competing services may represent anticompetitive rent-seeking behavior or efforts to deter welfare-reducing free riding.

Moreover, the Chicago school movement that infused economic analysis into the antitrust laws began to recognize that horizontal cooperation is not always harmful. Coordination among competitors, or networking, can increase economic welfare by reducing the supply costs. Just as a merger can increase efficiency by integrating the assets of the firms, a horizontal agreement can increase efficiency by working a partial integration of economic functions.[8]

It is ironic that disciples of economic analysis can resort to precepts of equal stature in either attacking or defending the ethical codes of professional associations. Government involvement in a system of ethics does not necessarily indicate whether the association's activities increase or decrease welfare. Scholars who disavow an efficiency model of antitrust interpretation are likely to be suspicious of private codes of ethics. They are also likely to subscribe to a public interest theory of regulation. These individuals would tend to prefer a state's code of professional behavior to one that is strictly the product of private agreement. Curiously enough, efficiency-based scholars who fear capture, though they too would be suspicious of ethical codes, would prefer a strictly private arrangement to one adopted by the government. Economic scholars who are concerned about free riding would find government involvement ambiguous.

In the end, we cannot simply declare that all professional codes are either efficiency-enhancing or efficiency-reducing, turn off the lights, and go home. This Article will first sketch the background of the legal and economic problem. It will next set out the anticompetitive theories of professional rules, and then the procompetitive, or welfare-enhancing explanations. The last section of the Article derives principles from this discussion and uses them to suggest a method of analysis for distinguishing anticompetitive rules from procompetitive ones.

II. THE NATURE OF PROFESSIONAL RULES

No definition of the term "profession" has ever been universally accepted, and this Article does not attempt to offer one.[9] One scholar wrote, "To define 'profession' is to invite controversy."[10] Part of the reason for the lack of a common definition is that many disciplines

8. One could summarize the last twenty years of antitrust evolution as follows, without doing too much damage to reality: All agreements were suspect. Chicago-school scholars argued that vertical arrangements were good and horizontal arrangements were bad. Another group of economists, to the cheers of traditional antitrust lawyers, argued that vertical arrangements really are bad. The Chicago-school then said horizontal arrangements may be good too. The war now rages on two fronts — what vertical arrangements are bad, and what horizontal arrangements are good?

9. One commentator concluded, "There is a rather extensive literature of definitions of profession. Research into these writings reveals no general agreement on any 'authoritative' statement." Cogan, *The Problem of Defining a Profession*, 297 ANUALS AM. ACAD. POL. AND SOC. SCI., ETHICAL STANDARDS AND PROF. CONDUCT 105 (B. Landis ed. 1955) [hereinafter ETHICAL STANDARDS].

10. *Id.*

have studied the phenomenon of a profession, including philosophy, sociology, political science, history, and economics. The emerging definitions naturally reflect the distinct perspectives and purposes of the particular discipline. One commentator ventured the following definition in 1926: "A profession consists of a limited and clearly marked group of men who are trained by education and experience to perform certain functions better than their fellowmen."[11] In 1915, a social scientist proposed six criteria that identify a profession: "(1) intellectual operations coupled with large individual responsibilities, (2) raw materials drawn from science and learning, (3) practical application, (4) an educationally communicable technique, (5) tendency toward self-organization, and (6) increasingly altruistic motivation."[12]

If one cannot successfully define what a profession is, one will not easily be able to describe what it is not. In particular, acclaim will not greet any effort to distinguish a profession from a trade.[13] Certainly at one time, the term profession was commonly associated only with the "learned" professions, such as law and medicine, occupations that require formal, post-secondary education.[14] Though not similar in all important respects, in many respects that economists find important, lawyers and physicians are indistinguishable from barbers, opticians, and watchmakers.[15]

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11. C. TAEUSCH, PROFESSIONAL AND BUSINESS ETHICS 13 (1926).

12. Flexner, *Is Social Work a Profession?*, 1 Sch. & Soc'y 904 (1915), quoted in Cogan, *supra* note 9, at 106. For a description of attempts by British commentators to define "profession" and an attempt at synthesizing them, *see* G. MILLERSON, THE QUALIFYING ASSOCIATIONS: A STUDY IN PROFESSIONALIZATION 1-13 (1964).

13. The Supreme Court once observed that the "classic basis traditionally advanced to distinguish professions from trades, businesses, and other occupations" is that "enhancing profit is not the goal of professional activities; the goal is to provide services necessary to the community." Goldfarb v. Virginia State Bar, 421 U.S. 773, 786 (1975).

14. One scholar has explained that in England, before the industrial age, young men in the upper classes were not likely to enter the trades, by becoming a blacksmith, carpenter, tailor, or shopkeeper, because commercial morality was not high and because those occupations did not pay enough. W. READER, PROFESSIONAL MEN: THE RISE OF THE PROFESSIONAL CLASSES IN NINETEENTH-CENTURY ENGLAND 6 (1966). Rather, the occupations considered suitable for most "gentlemen" were

> the 'liberal professions', and of those there were only three: divinity, physic, and law.
>
> 'Profession', by itself, was a word that could be used of any 'calling, vocation, known employment' . . . and it frequently turns up in the phrase 'mechanical professions', meaning the trades of skilled workmen. The force of much that later came to be absorbed into the word 'profession' was carried in the adjective 'liberal', which meant that the essential qualification for entry into any of these three occupations, which were sometimes also called the 'learned' professions, was a liberal education: that is, the education of a gentleman, not of a trader or an artisan.

Id. at 9-10.

15. The problem of distinguishing professions from other occupations is noted by one scholar in a recent economic survey of government regulation of occupations in the United States. *See* S. YOUNG, THE RULE OF EXPERTS: OCCUPATIONAL LICENSING IN

Fortunately, the analysis in this Article does not require a precise definition. The analysis contemplates that a profession generally has the following attributes: Practitioners provide a service, rather than supply a product. They usually provide their service directly to consumers, at least the demand side of the market is atomistic. The ability to provide the service, as well as the manner in which it is provided, are commonly regulated by the government, but entry into the occupation by legally-qualified individuals is otherwise rather easy. Finally, the individual is often the economic entity supplying the service, though individuals also combine to form firms. In any event, the supply side of the market is also atomistic. As is clear from this list, the term "profession" is used in this Article to denote what are commonly considered professions and some less traditional professionals.[16]

Professionals tend to form associations. These private associations establish rules that prescribe requirements for initial membership, or eligibility requirements. This Article addresses only those associations comprised primarily of members of the profession, that is, those that are made up of competitors. The eligibility requirements of any such association implicitly incorporate any qualifications imposed by law for engaging in the profession. In theory, the association need

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AMERICA 1-4 (1987). He chose to use the terms "profession" and "occupation" interchangeably to avoid obscuring "the true economic forces at work in the regulation of occupational activity." *Id.* at 4.

16. In their papers explaining an anticompetitive theory of association rules, discussed *infra* at notes 80-88 and accompanying text, Langenfeld and Morris assert that their analysis is applicable to any horizontal agreement. *See* Langenfeld & Morris, *Rent Increasing Costs: The Antitrust Implications from a Paradox in Value Theory*, Bureau of Econ., Fed. Trade Commission, Working Paper No. 182 (Nov. 1990) [hereinafter Langenfeld & Morris, *Rent Increase Costs:*]; Langenfeld & Morris, *Analyzing Agreements Among Competitors: What Does the Future Hold?*, (Paper presented at the Contemporary Policy Session of the Western Economic Association's 65th Annual Conference, San Diego, California) (June 1990) [hereinafter Langenfeld & Morris, *Analyzing Agreements*]. Whether the mode of analysis suggested in this Article could be extended to any horizontal agreement, has not been carefully considered herein. However, as a general matter, national trade associations consisting of firms with relatively high fixed costs selling tangible products tend not to have sufficient power to force members to comply with a code of conduct. These associations typically have not secured government adoption of their rules. And membership in the association has not been significant enough commercially that a firm would be economically compelled to adhere to the association's code. Thus, a firm that could profit by engaging in conduct prohibited by such an association's code would likely leave the group.

The rules used as examples throughout the Article are generally taken from the codes of professions as that term is described in the text. Occasionally, however, an association is used that does not correspond to the criteria indicated because the rule happens to illustrate a point particularly well or the nature of the group is not obvious. Given that these rules are used merely as examples, little harm is thereby done.

not impose any additional eligibility requirement, though virtually all associations at least require the payment of an initiation fee or dues. However, an association may establish eligibility requirements that far exceed legal mandates. An association may constitute a very large or very small percentage of a profession. Accordingly, the proportion of any relevant market consisting of members may be large or small.

The rules of professional associations also typically contain restrictions on the conduct of members, commonly called rules of ethics, but the nature, scope, and detail of these conduct restrictions vary enormously among associations.[17] Codes of ethics can range from little more than a declaration that members will discharge their "duties with accuracy, thoughtfulness, and care,"[18] to elaborate statements of principles and conduct imperatives, supported by case hypotheticals and commentary.[19] Thus, ethical rules can command, prohibit, allow, encourage, exhort, or discourage behavior. They can specify obligations that are also imposed by statute, administrative regulation, or the common law. Indeed, they can simply state explicitly that members will comply with the law.[20] An association may establish rules that are later adopted by a government authority,

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17. One scholar, after surveying a variety of ethics codes, defined the following four types:

(1) The code which is a collection of specific rules of conduct, worded so as to apply with definiteness to situations faced by the members of the profession. . . . (2) One which is a collection of two types of articles — precise definitions of situations and what may be termed general principles or remote ideals. . . . (3) One which is a collection solely of general principles which set no standards and which cannot be classified as specific rules. . . . (4) One which consists of general principles which are constantly applied to situations through the rulings of a practice committee that attempts to accumulate precedents or a body of common law.

B. LANDIS, PROFESSIONAL CODES: A SOCIOLOGICAL ANALYSIS TO DETERMINE APPLICATIONS TO THE EDUCATIONAL PROFESSION 87-88 (Contributions to Education No. 267, 1927).

18. *See*, Code of Ethics of the American Society of Medical Technology, *reprinted in* J. CLAPP, PROFESSIONAL ETHICS AND INSIGNIA 439 (1974). The principle provisions of another code, adopted in 1921, enjoined the association's members, *inter alia*, to develop "in business the spirit of the Golden Rule," to "establish the spoken word on the basis of the written bond," and to "assist liberally and sympathetically all that seeks to elevate humanity by charity of action and thought and by justice to all men through the 'Square Deal'." I could not resist contriving some excuse to mention that organization, which was made up of lumbermen, because of its name — the Concatenated Order of Hoo-Hoo. *See* E. HEERMANCE, CODES OF ETHICS: A HANDBOOK 311-12 (1924). My only fear is that the reference will inspire the reader to sum up this Article as some other assemblage of hoo-hoo.

19. *See, e.g.*, the Code of Professional Responsibility of the American Bar Association or the Code of Professional Practice of the American Society of Landscape Architects, the 1962 version of which is reported in J. CLAPP, *supra* note 18, at 396-402.

20. Of particular relevance to this Article is a provision of the Code of Ethics of the Professional Photographers of America: "I will at all times avoid the use of unfair competitive practices as determined by any court of competent jurisdiction, the Federal anti-trust laws and related statutes." J. CLAPP, *supra* note 18, at 559.

then rescind or retain them. Conversely it may adopt a state's prior restrictions or adopt restrictions simultaneously with the state.[21] Certainly the restrictions may specify obligations that are not founded on any requirement of law. Indeed, the purpose of this Article is to identify restrictions that violate the antitrust laws.

Associations vary in the extent to which they enforce their rules. Some associations specify conduct restrictions but create no formal enforcement mechanism.[22] "Obligations" that are not enforced have little relevance to an analysis of the antitrust implications of professional rules.[23] For agreements among competitors to be exclusionary, they must be enforced against the disadvantaged rivals. As Judge Easterbrook has written, "There can be no restraint of trade without a restraint."[24] Collusive agreements, those designed to raise price merely by consensual action of the parties to them, may be attempted without an enforcement provision, but they are likely to be short-lived. The incentive to cheat either by shading price or avoiding costly business practices will become irresistible. In any event, it is unlikely that a group of competitors would attempt to effectuate a cartel agreement through an association and not enforce the pact.[25] Therefore, the following discussion only covers rules that are enforced. A private association may use a variety of sanctions to enforce its rules, including reprimand or suspension,[26] but the ultimate and decisive club that an association wields is dismissal from membership. If private sanctions are not effective, the association may turn to the state for help.

Conduct restrictions contained in a code of ethics need not be enforced according to their terms. A particular rule may be competi-

21. The term "state" is used throughout this Article as a synonym for any government authority. As a matter of fact, the regulation of professions in this country is generally the province of state government, accomplished through legislation and administrative regulation, rather than federal government.

22. *See, e.g.*, the American Personnel and Guidance Association, discussed in J. CLAPP, *supra* note 18, at 202-03; the American Society of Chartered Life Underwriters, *id.* at 374; and the National Funeral Directors Association, *id.* at 314.

23. *See generally*, W. Moore, *supra* note 1, at 119 ("[w]ithout review and enforcement mechanisms, professional codes may be little more than window dressing, perhaps more designed to give false comfort to the laity than to guide the practitioner.").

24. Schachar v. Am. Academy of Ophthalmology, Inc., 870 F.2d 397, 397 (7th Cir. 1989).

25. For a discussion of private methods of enforcing cartel agreements, *see* Lopatka, *The Case for Legal Enforcement of Price Fixing Agreements*, 38 EMORY L. J. 1, 8-24 (1989).

26. *See, e.g.*, the National Society of Interior Designers, discussed in J. CLAPP, *supra* note 18, at 385-86.

tively ambiguous, but enforced in an anticompetitive way. At the extreme, an association can enforce an obligation that is not found in a written code or even one that directly contradicts a written rule. For antitrust purposes, the restriction is that which is enforced. The rules examined in this Article are contained in association codes, however the reader must bear in mind that welfare-enhancing written obligations do not necessarily increase welfare in practice.

This article concerns rules of private professional associations which govern eligibility and subsequent conduct when enforced.[27] The object is to formulate a method of determining what rules decrease economic welfare and are therefore good candidates for antitrust condemnation. To do this, this Article will also assess the welfare-enhancing potential of these rules. First, the anticompetitive theories.

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27. Throughout the Article, actual written rules of associations are used to illustrate points. Association codes are normally revised over time, and the rules identified are taken from codes of various eras. For purposes of this analysis, early codes, especially those in force prior to 1950 or so, can be more illuminating than older ones. Rules adopted before associations perceived that they could violate the antitrust laws are likely to tell more about whether they should violate those laws, whether the rules were efficient. Today an association might avoid adopting an efficient rule, or adopt a less efficient alternative, only because it fears antitrust liability. In 1950, the Supreme Court held that price fixing by real estate brokers was a *per se* antitrust violation. United States v. National Ass'n of Real Estate Boards, 339 U.S. 485, 492 (1950). In 1975, the Court held that price fixing by attorneys violated the antitrust laws. Goldfarb v. Va. State Bar, 421 U.S. 773, 788 (1975). Yet in *Goldfarb*, the Court acknowledged that "until the present case, it is clear that we have not attempted to decide whether the practice of a learned profession falls within § 1 of the Sherman Act." *Id.* at 786 n.15. At least associations of "learned" professionals, then, were not sure that their rules could violate the antitrust laws until 1975, though they and other professional societies should have been concerned by 1950.

Clearly the associations of learned professionals in this country had codes long before 1950. The first code of the American Medical Association was adopted in 1848. *See* B. Landis, *supra* note 17, at 41. The American Bar Association adopted cannons of ethics in 1908. *Id.* at 26. The American Society of Civil Engineers was founded in 1852 and adopted a code. *See* C. TAEUSCH, *supra* note 11 at 100. The American Association of Engineers followed and adopted a code in 1915. *See* B. LANDIS, *supra* note 17, at 54. The American Institute of Architects adopted canons of ethics in 1909. *See* Cummings, *Standards of Professional Practice in Architecture*, in ETHICAL STANDARDS, *supra* note 9, at 12. Many trade associations, however, appear to have adopted codes of conduct in the twenties. The impetus for these codes has been attributed to the Federal Trade Commission, which in November of 1918 began to invite members of entire industries to submit in concrete form their conclusions about competitive practices they considered unfair. *See* R. CABOT, ADVENTURES ON THE BORDERLANDS OF ETHICS 77 (1926). *See also* the Annual Report of the Federal Trade Commission for the Fiscal Year Ended June 30, 1920, at 43. It is ironic that the FTC has recently targeted trade associations for antitrust scrutiny. *See* Prepared Remarks of Kevin J. Arquit, Director, Bureau of Competition, Federal Trade Commission, before the Chicago Bar Association Antitrust Law Committee (Jan. 17, 1990).

III. Anticompetitive Theories of Professional Rules

A number of anticompetitive theories have been offered either to explain or because they have clear application to horizontal restrictions on either the conduct of professionals or their ability to practice. As used here, the term "anticompetitive" refers to a decrease in economic welfare, or the total of consumer and producer surplus, that results from a restraint. It is possible for economic welfare to shrink even when consumer welfare is unchanged. It is also possible to hypothesize that competitors have a profit incentive to effectuate a restraint that reduces producer welfare but does not affect consumer surplus,[28] though all the theories described below predict a loss of consumer welfare.

This article begins its discussion of anticompetitive theories with the most traditional. No attempt is made in this section, or the next, to assess whether a theory is a viable explanation for all common ethical rules. Rather, common restrictions are selected to illustrate the applicability of each theory based upon their most obvious effects. Some restraints will appear to have little to do with some theories; conversely, some theories could apply to the same restraint. The importance of identifying the most likely explanation for a restriction is discussed in Section V.

A. *Fixing Price Above Marginal Cost*

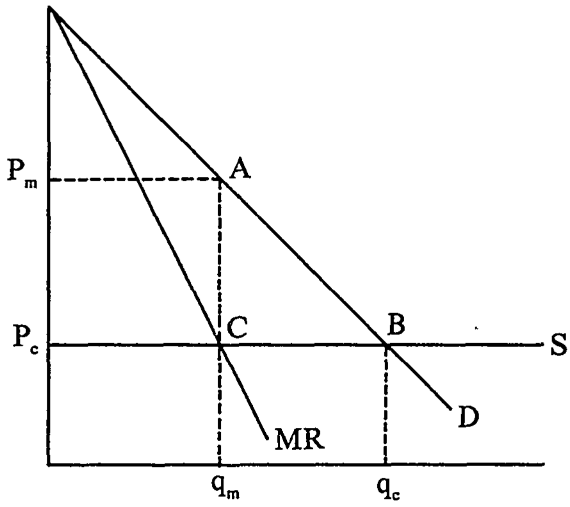
The classic explanation for a horizontal restraint on competition is that it enables suppliers to raise prices above marginal cost and reduce output, ideally to supply the quantity identified by the intersection of marginal cost and marginal revenue and to charge the corresponding price.[29] The result is illustrated in Figure 1.[30] The

28. A restraint conceivably could increase the profits of a particular supplier or group of suppliers yet reduce the profits of the remaining suppliers more than an offsetting amount. If the changes in these profits are caused by changes in marginal costs while the price and quality-adjusted output of the industry remain unaffected, producer but not consumer welfare would decline. The restraint would not be in the interests of suppliers as a group, but the suppliers that would stand to gain may be able to secure the restraint against the opposition of the other suppliers. This postulate is essentially a variant of the raising rivals' costs theory discussed below, in that under both hypotheses a restraint causes some suppliers to gain and others to lose. The difference is that the conventional raising rivals' costs explanation predicts a loss of consumer welfare.

29. Any microeconomics or industrial organization textbook will provide an analysis of the cartel model. *See, e.g.*, D. Carlton & J. Perloff, Modern Industrial Organization 209-11 (1990); H. Kohler, Intermediate Microeconomics: Theory and Applications 321-35 (1982). *See also* H. Hovenkamp, Economics and Federal Antitrust Law 1-19 (1985).

restriction does not affect the industry demand curve but does cause price to increase from p_c to p_m, and quantity to decrease from q_c to q_m. This change produces the familiar deadweight loss represented by triangle ABC and a transfer of wealth from consumers to producers represented by rectangle p_mACp_c. Suppliers have an incentive to engage in such a restriction because of the resulting economic rents.

FIGURE 1



An obvious example of this kind of restriction is an agreement to fix the price of some service, such as an agreement among attorneys to charge specified fees for title searches and other common legal services. In essence, this was the allegation in *Goldfarb v. Virginia State Bar.*[31] Similarly, *United States v. National Association of Real Estate Boards*[32] involved an alleged agreement among real estate brokers to charge specified commissions for brokerage services.

For this theory to work, the professional association that adopts the restraint must have market power vis-a-vis non-member professionals.[33] In other words, the association members must face a down-

30. The supply curve in Figure 1 is drawn as a horizontal line at p_c. The analysis of this anticompetitive theory would not be affected if the supply curve sloped upward.

31. Goldfarb v. Va. State Bar, 421 U.S. 773, 775-76 (1975) (County bar association published a schedule of recommended minimum prices for common legal services, including 1 percent of the value of the property involved for a title examination).

32. United States v. Nat'l Ass'n of Real Estate Boards, 339 U.S. 485, 488 (1950).

33. Technically, market power requires that the cartelists have power with respect to the service whose price is fixed. If consumers can costlessly substitute a different service for that whose price is set by the cartel, the association will have no market power even if membership in the association is required to provide the cartelized service. For

ward sloping demand curve; the more steeply sloped the demand curve, the greater the potential monopoly profits, and the stronger the incentive to collude.[34] If non-members of the association can easily expand output in response to a curtailment by the members, and assuming that consumers are adequately informed about fees, the members will not be able to raise price. Consumers will simply switch to non-members if members raise price. In effect, the members will face a horizontal demand curve at the competitive price. This requisite market power in the association also implies that members cannot inexpensively leave the association to escape the ethical rule fixing price and compete against remaining members.

Adherence to a set of ethical restrictions may be mandated by law. This might be accomplished by a legal requirement that all professionals belong to a particular association, which then imposes a code of ethics on its members. For example, in states with integrated bars, attorneys must belong to the state bar association in order to practice law. The bar has its own set of ethical restrictions, and there are no competing non-members.

Alternatively, a private association may convince a government to impose, legislatively or administratively, a set of restrictions as a condition for offering professional services. For instance, a society of accountants may persuade a state board of accountancy to prescribe a set of restrictions for all accountants in the state. In effect, the association persuades the government authority to adopt its code of ethics as the standard for the industry; professionals gain no competitive advantage in refusing to join, or by dropping out of the association.[35]

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example, if consumers are indifferent between financial planning offered by tax attorneys and that offered by tax accountants, the lawyers will have no market power even if all attorneys must belong to the bar association. One could view the two professions as providing the same service, with non-members (accountants) competing with members (lawyers). Or one could view the services as distinct but interchangeable. With respect to professional services, a particular service often can be provided only by members of a single profession, and so it is usually more comfortable to use the concept of a single service offered by members or non-members of the association in conducting antitrust analysis.

34. *See, e.g.*, D. CARLTON & J. PERLOFF, *supra* note 29, at 217.

35. This paper is concerned with theories of economic harm and benefit of ethical restrictions and the antitrust treatment that would therefore be appropriate. It does not focus on the application of legal doctrines that are based essentially on non-economic considerations. The *Noerr-Pennington* doctrine would most likely insulate a society from antitrust liability for persuading a government entity to adopt anticompetitive regulations. *See* Eastern R.R. Pres. Conf. v. Noerr Motor Freight, 365 U.S. 127 (1961); United Mine Workers v. Pennington, 381 U.S. 657 (1965). *See generally* 1 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 201-04 (1978). The state action doctrine could well

Membership in an association can also be an economic necessity.[36] It may reduce the costs of providing professional services so that non-members cannot compete. This is the classic, though disputed, "essential facilities" doctrine.[37] For instance, suppose participation in a multiple listing service reduces the cost of facilitating real estate sales, so that non-participants cannot economically offer brokerage services. As long as the group did not set a price so high that non-members could survive in the market, a real estate broker would have to join the multiple listing service and adhere to its set of rules.[38]

Even if a professional association has market power, or has induced a government entity to ratify its ethical rules, the standard cartel explanation for ethical restrictions may be problematic. First, prices for heterogeneous services cannot easily be set by a cartel, and professional services are often heterogeneous.[39] As the number of variables in the value of a service increases, the process of fixing prices and of policing a cartel agreement become increasingly complex. The members cannot be capable of competing away the available profits on unrestricted dimensions of the service that make the service more valuable to consumers. If this theory applies, one would expect to see explicit price restrictions only on services that are fairly

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protect the association from complying with the rules imposed. *See supra* note 2. This paper addresses only in passing the appropriate application of those doctrines.

36. Of course, an association with neither legal clout nor economic power can nonetheless declare that its mandates must be observed by the profession. The American Chiropractic Association, in its 1971 Code of Ethics, proclaimed, "The honor and dignity of the chiropractic profession may best be upheld, its sphere of influence expanded, and its science advanced through the association of all chiropractors in state and national organizations. Hence it is the duty of each chiropractor to associate himself with such bodies." *See* J. CLAPP, *supra* note 18, at 160.

37. The doctrine typically is traced back to United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912) (railroads that owned access to the only means of crossing the Mississippi River at St. Louis were required to allow competing railroads to become joint owners). It has been applied subsequently to cooperation among news gatherers (Associated Press v. United States, 326 U.S. 1 (1945)), among stockbrokers (Silver v. New York Stock Exch., 373 U.S. 341 (1963)), and, though the Court explicitly disclaimed reliance on it, between operators of ski lifts (Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985)). The doctrine has recently been challenged in Reiffen & Kleit, *Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?*, 33 J. L. & ECON. 419 (1990).

38. To distinguish clearly the cartel anticompetitive theory discussed in this subsection from the theories discussed later, the reduction in cost brought about by membership must be unrelated to the ethical restriction at issue. For example, if the efficiencies offered by a multiple listing service do not require that participants set brokerage fees, a fee-setting agreement could be condemned without any loss in static efficiency. *See infra* note 95. If the restriction under investigation itself reduces cost, then it will not be anticompetitive. Theories of anticompetitive harm, described later, postulate that the restriction increases cost and thereby reduces economic welfare.

39. *See, e.g.*, R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 59-60 (1976); D. CARLTON & J. PERLOFF, *supra* note 29, at 221-22; F. SCHERER & D. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 279-82 (3rd ed. 1990).

homogenous and invariant to quality. Indeed, the restrictions on attorneys' fees in *Goldfarb* apparently applied only to rather mundane activities, such as title searches.[40]

Second, the number of suppliers of professional services in a geographic market is likely to be quite large. As the number of suppliers increases, the costs of coordination and policing also increase.[41] Any restraint that increases price above marginal cost invites cheating. Depending on the legal and economic setting involved, the ease of detecting and determining cheating will vary. At the extreme, expulsion from an association may mean expulsion from the profession. However, even if expulsion is used as the ultimate sanction, the transgression first has to be discovered. A professional is not likely to risk expulsion cavalierly, yet chiseling on the price of professional services is not intrinsically apt to be discovered.

Even if an association with market power can raise prices for some services above marginal cost and keep cheating to tolerable levels at an acceptable cost, the association will still have to expect to profit from the endeavor before the members will engage in it. If the restriction generates economic rents, it will attract entry. That entry will dissipate what otherwise would have been monopoly profits.

This forecast poses the following question: Why would a group of suppliers agree to a restriction that will reduce output but will not generate rents? The answer usually offered is that entry will not be immediate, and so the restriction can generate rents in the interim, or transitional rents. Assuming that competition from rivals charging lower prices can be prevented, the restriction is retained even after entry has eliminated the rents, for if the restriction were dropped, suppliers would incur the costs of excess capacity, and some would be squeezed out of the market. Of course, if the members of the association are unwilling to rescind a restriction due to the costs they might incur, they will need to be confident that they can maintain the restriction before imposing it in the first place. If the market power of the group or the efficacy of the restriction depends upon government action, which will never be wholly within the control of the association's members, significant uncertainty about continuing government support will make them hesitant to adopt the restraint. In other words, the diminishing stream of expected transitional rents,

40. *See* Goldfarb, 421 U.S. at 776 (fee schedules provided recommended minimum prices for common legal services).

41. *See, e.g.*, R. POSNER, *supra* note 39, at 55-56; D. CARLTON & J. PERLOFF, *supra* note 29, at 220-21; F. SCHERER & D. ROSS, *supra* note 39, at 277-79.

discounted to present value, will have to exceed the discounted expected costs.

Perhaps because the characteristics of most professional markets are not conducive to cartel pricing, few association codes have been found with explicit restrictions on price or output. A code might admonish members to charge customary fees, and an association could have some ancillary method of announcing specific prices and a policy of enforcing strict adherence to them. In addition, restrictions that do not explicitly set price or output could conceivably result in the cartel solution. The restrictions could also facilitate a cartel agreement that is not embodied in the code. It would be surprising to find explicit price restrictions in formal ethical codes after *Goldfarb*[42] and *National Association of Real Estate Boards*.[43] In *Goldfarb*, the Supreme Court held that price fixing by professionals who are not immunized by state action violates the antitrust laws. However, given the difficulties inherent in setting prices and policing the agreement, a professional rule would have to be plain and specific to function as a cartel device. Broad directives to charge prices that cover costs,[44] or that take into account the prices of competitors,[45] are likely to be mere exercises in wishful thinking. Whether expressed in imperative or encouraging language, they have, and are ruefully expected to have, no market impact.[46]

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42. *See supra* note 31.

43. *See supra* note 32.

44. *See, e.g.*, the 1922 Code of Ethics of the American Pharmaceutical Association, reported in E. HEERMANCE, *supra* note 18, at 421 (fees "should take into account the time consumed and the great responsibility involved as well as the cost of the ingredients"); the 1923 Code of the Photographers' Association of America, *id.* at 432 ("we cannot reasonably be giving true service unless we know what it costs us to sell and unless we sell at a price which will give us a return proportionate to our skill and to our expense"); the 1891 Code of the United Typothetae of America, *id.* at 439 ("we should never forget that there must be as surely levied on each particular job as its labor cost").

45. *See, e.g.*, the 1971 Code of Ethics of the National Society of Professional Engineers, reported in J. CLAPP, *supra* note 18, at 255 (the engineer "will not undertake work at a fee or salary below the accepted standards of the profession in the area"); the 1963 Ethical Standards of the American Psychological Association, *id.* at 631 (in establishing rates, "the psychologist considers carefully . . . the charges made by other professional persons engaged in comparable work"); the 1972 Ethical Standards of the American Personnel and Guidance Association, *id.* at 206 (in establishing fees, the member "shall . . . take careful account of the charges made for comparable services by other professional persons"). In its 1904 Code, the American Osteopathic Association stated that local groups of doctors should fix prices: "Some general rules should be adopted by the physicians in every town or district relative to the minimum pecuniary acknowledgment from their patients; and it should be deemed a point of honor to adhere to these rules with as much uniformity as varying circumstances will admit." E. HEERMANCE, *supra* note 18, at 354. Such an admonition is no more likely to have an anticompetitive effect than the examples above.

46. Another kind of rule that is the equivalent of an exhortation to charge high prices is one that enjoins members to charge fair, just, or reasonable prices. For example, the 1959 Code of Ethics of the American Congress on Surveying and Mapping provided, "It shall be considered unprofessional . . . [t]o attempt to obtain or render technical

Although the act of setting prices above marginal cost while demand remains constant, cannot be dismissed as an impossible explanation for ethical restrictions, it is not an especially promising theory. It cannot explain the bulk of common ethical restraints. Consequently, economists have offered other anticompetitive explanations, the most prominent of which follow.

B. Increasing Consumers' Search Costs

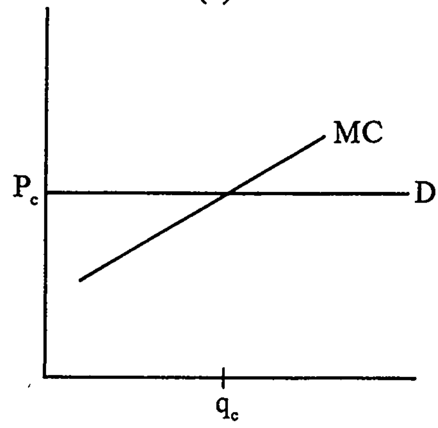
Perfect competition requires a large number of sellers and perfect information on the part of buyers.[47] If a seller raised price above the market level, all buyers who would otherwise have purchased from the seller would immediately switch to another supplier because they know that a lower price is available elsewhere. Because the would-be price raiser's output, even at the competitive price, constitutes an insignificant proportion of total industry output, the other sellers would easily be able to absorb the additional sales volume without experiencing an increase in costs. Therefore, no single supplier has power to affect price. This situation is illustrated in Figure 2(a). From the standpoint of any firm, the demand curve is a horizontal line at p_c. The firm can supply as much product as it wants at that price, but will not sell any product above that price. It will set output where its marginal cost intersects with demand, at q_c.

services or assistance without fair and just compensation commensurate with the services rendered." *See* J. CLAPP, *supra* note 18, at 747-48.

47. For general discussions of the assumptions underlying perfect competition, see D. CARLTON & J. PERLOFF, *supra* note 29, at 66-67; H. KOHLER, *supra* note 29, at 42-44.

FIGURE 2

(a)



Suppose, however, that consumers do not have a costless supply of price information. They cannot immediately switch away from the deviant firm because they do not know where a lower-price seller can be found. They would have to search one out, and that search is costly.[48] A firm can set price above its marginal cost, secure in the knowledge that its customers will not be economically able to switch to an alternative seller.[49] If all buyers incur the same significant search costs, the market will move toward a single price equilibrium at the monopoly level.[50]

However, consumers of professional services are not likely to have identical search costs, no matter what sellers might do to increase them. The main cost incurred in the search for the lowest price for professional services is likely to be time, which consumers value differently. Thus if search cost is viewed as an opportunity cost, the

48. For an excellent discussion of the effects of imperfect information in markets, see D. CARLTON & J. PERLOFF, *supra* note 29, at 554-88. For a more technical presentation, see L. PHLIPS, THE ECONOMICS OF IMPERFECT INFORMATION (1988). An interesting article written for lawyers that applies the economics of information to the enforcement of contracts is Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979).

49. The information deficiency necessary to permit suppliers to raise price need not be complete. Consumers may know the initial distribution of prices in a market, but if they do not know which firm charges which price, and must incur costs to find that out, they may pay a price that they know exceeds the average. Consequently, prices in the market will gravitate toward the monopoly level.

50. *See* Scitovsky, *Ignorance as a Source of Oligopoly Power*, 40 AM. ECON. REV. 48 (1950); Diamond, *A Model of Price Adjustment*, 3 J. ECON. THEORY 156 (1971). For surveys of the relevant literature, see Salop, *Information and Monopolistic Competition*, 66 AM. ECON. REV. 240 (1976); Stiglitz, *Equilibrium in Product Markets with Imperfect Information*, 69 AM. ECON. REV. 339 (1979).

amount of time spent searching will result in different costs to different consumers, depending on the alternative uses of their time. For example, if price advertising for televisions were suddenly eliminated, consumers would be forced to spend more time searching, or shopping, for the best price. However, that shopping would impose higher costs on some consumers than on others.[51]

When a market consists of some informed consumers (those with low search costs) and some uninformed consumers (those with high search costs), it may nevertheless produce a single price equilibrium at marginal cost, which is the outcome of perfect competition.[52] For instance, if a seller raised price, the seller could continue to sell to all of the uninformed consumers that happened to come into the business, but would lose all informed consumers. If the proportion of uninformed consumers is sufficiently small, the seller will not find it profitable to sell only to uninformed buyers.

However, if the proportion of uninformed consumers is large, a market may result in which some suppliers charge prices above marginal cost and others charge prices at marginal cost. Depending on the severity of the assumptions, the market may produce a two price equilibrium, one price at marginal cost and the other at the monopoly level, or an array of prices.[53] For example, the hypothetical seller may raise prices and lose all informed buyers, but still profit by charging the monopoly price to its share of uninformed buyers. Another firm may find it profitable to charge a lower price and capture informed consumers, as well as its share of uninformed consumers.

Just how large the proportion of informed consumers in the market must be in order to produce the results of perfect competition, depends on the shape of the average total cost curves of the firms in the industry and the amount above marginal cost that consumers are willing to pay.[54] As fixed costs in an industry decrease, the propor-

51. Indeed, increasing the time spent searching can impose negative costs on a consumer. Searching for a better price is another way to describe shopping, and consumers may derive positive utility from the act of shopping. However, shopping for bargains in professional services is not likely to be a popular pastime.

52. For a non-technical explanation of this result, see D. CARLTON & J. PERLOFF, *supra* note 29, at 573-74.

53. *See generally* Butters, *Equilibrium Distribution of Sales and Advertising Prices*, 44 REV. ECON. STUD. 465 (1977); Rothschild, *Models of Market Organization with Imperfect Information: A Survey*, 82 J. POL. ECON. 1283 (1974); Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961); Salop & Stiglitz, *Bargains and Ripoffs: A Model of Monopolistically Competitive Price Dispersion*, 44 REV. ECON. STUD. 493 (1977).

54. *See* D. CARLTON & J. PERLOFF, *supra* note 29, at 574.

tion of informed consumers necessary to produce a market price at marginal cost increases. This is because less revenue is needed to cover total costs when fixed costs decrease; a firm may find it profitable to do a small volume of business with uninformed buyers. As the price that consumers are willing to pay rises above marginal cost, the profit is greater on each sale, and the minimum profitable sales volume is lower. Thus, as the demand curve *net of search costs* becomes more steeply sloped, a greater proportion of informed consumers is needed to produce the competitive result.

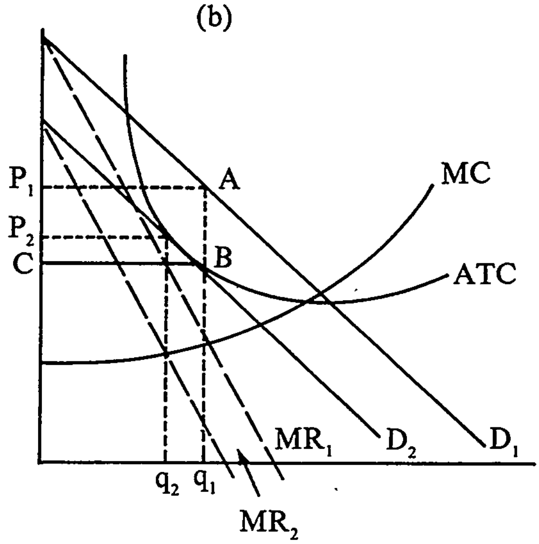
The effect of changing a market from one in which all consumers have perfect information to one in which some consumers are uninformed is to change the residual demand curve facing each firm from a horizontal line to a downward sloping one. Depending on the slope of the demand curve and its average total cost curve, a firm may be able to set price above marginal cost and earn economic rents. However, if entry into the market by qualified suppliers is unlimited, the rents will attract entry. As new firms enter, the residual demand curve facing each firm will shift to the left until no firm is earning profits.[55] This, in essence, is a model of monopolistic competition.[56]

The process is illustrated in Figure 2(b). When all consumers are perfectly informed, the seller faces the horizontal demand curve in Figure 2(a). If the market suddenly changes so that a large proportion of consumers are uninformed, the demand curve facing the firm becomes downward sloping, taking the shape D_1 in Figure 2(b). Now the firm equates marginal cost with the new marginal revenue curve associated with the new demand, MR_1. The firm raises price to p_1, sells q_1 units, and earns profits represented by rectangle p_1ABC. The profits are the difference between total revenue, measured by price times output, and total costs, measured by average total cost times output. These profits attract new firms, and as they enter, the residual demand curve facing the firm shifts to the left. Eventually, demand shifts to D_2, where it is tangent to the average total cost curve, generating the new marginal revenue curve MR_2. The firm now equates marginal cost and marginal revenue, sets price at p_2, sells q_2 units, and earns zero profits.

55. If some firms in the market find it profitable to charge a low price in order to capture informed consumers, entry will force that price down to marginal cost and dissipate any profits.

56. *See* Salop, Information and Monopolistic Competition, *supra* note 52; D. Carlton & J. Perloff, *supra* note 29, at 570-71, 313-32.

(b)



Several implications of this model should be emphasized. First, the event that increases search costs does not have to affect the costs borne by the firms. Their costs could increase or decrease, but the model depends on a change in demand, not a change in the costs of the supplies. Further, the model does not require increasing marginal costs. A market in which all firms have the same constant marginal costs can produce the same result, so long as firms have some fixed costs.

The welfare effects of monopolistic competition, though generally ambiguous, are typically negative.[57] Where the industry supplies an undifferentiated, or homogenous product, welfare is reduced because price exceeds marginal cost. If marginal costs are constant, the economy will incur excessive fixed costs. That is, the number of firms will be supra-optimal. Where the industry supplies differentiated products, price again exceeds marginal cost, but the industry may produce too much or too little variety. There may be too many or too few firms.

If an association of professionals can effectuate a restraint that increases consumer search costs, its members may profit, at least in

57. *See generally* D. CARLTON & J. PERLOFF, *supra* note 29, at 326-42.

the short-run, and economic welfare may suffer. For example, suppose professionals at one time engage in extensive price advertising, and consumers are consequently fully informed about price at no cost to themselves.[58] The association then manages to suppress price advertising, so consumers are forced to seek out low-price suppliers through various search activities, perhaps by telephoning various providers. Some consumers will find these search activities prohibitively costly, and will be content to pay any price up to their reservation prices for the service.[59] If enough consumers react this way, each professional may be able to profitably raise the price above marginal cost.

Although the result is the same as in the previously discussed cartel model, this model does not require any agreement on price among the suppliers. However, like the previous model, it implicitly requires that the members of the association have the power, collectively to affect price, thereby increasing consumer search costs. For example, if a single professional refused to advertise price, consumers would simply patronize those professionals who advertise. The association would have to account for a large percentage of the professionals in the market, though perhaps not as large of a percentage as is required to raise price by limiting output, and this implies a legal or economic requirement of membership. Further, the association would have to enforce the restriction among its members. Again, like the cartel model, the search cost theory is only plausible if the expected short run profits earned before entry exceed any expected losses.

In both the cartel and search cost models, suppliers profit by charging a price in excess of marginal cost, and market price exceeds the industry marginal cost at the output supplied. In the cartel model, the association produces the result by restricting the prices offered, a process that affects neither the shape of the demand curve

58. This analysis assumes that search costs decrease as the volume of costless information increases. In fact, to be perfectly informed, consumers must mentally process the raw information received, and this process, because it takes time, imposes costs. As a result, more information can theoretically make consumers less well informed. A study of physician services concluded that an increase in the number of providers resulted in an increase in consumer search costs and an increase in average prices. Pauly & Satterthwaite, *The Pricing of Primary Care Physicians' Services: A Test of the Role of Consumer Information*, 12 BELL J. ECON. 488 (1981).

59. The posited increase in consumer search costs brought about by the elimination of price advertising assumes that an equal amount and quality of information is not available to consumers at no cost from other sources. If professionals convey the same price information through activities other than price advertising, a ban on advertising will have no effect on search costs. The ban would have to extend to those other activities. When professionals incur different costs in engaging in different information dissemination activities, a ban on any one activity may have anticompetitive effects. This is the subject of the theories discussed in the following sub-sections, especially "Raising the Marginal Costs of All Suppliers."

nor the shape of the supply curve. In the search cost model, the association generates the result by a restraint that affects the shape of the demand curve, but does not necessarily affect the shape of the supply curve.[60] In the following two models, anticompetitive effects are predicted to result from restraints that affect the shape of the supply curve but not necessarily that of the demand curve. What's more, neither depends on a market price that exceeds marginal cost.

C. Increasing the Marginal Costs of Marginal Suppliers

The recent literature on "raising rivals' costs" has achieved notoriety principally as a theory of anticompetitive harm flowing from vertical transactions. Associated primarily with Steven Salop, David Scheffman, and Thomas Krattenmaker, the theory postulates that a firm in a competitive output market can profitably raise the marginal costs of its rivals by restricting the supply of a vital input and thereby increase output price.[61] The firm incurs a fixed cost in securing the restriction, for example, by paying input suppliers not to sell to its rivals. The reduced input supply forces up the price of the remaining input available to the predator's rivals, which increases the rivals' marginal costs. This increase in the disadvantaged firms' marginal costs causes the industry supply curve in the output market to rotate in a counterclockwise direction from its origin. Market price is still set at the intersection of supply and demand, but now price is higher and output is lower. Thus, economic welfare is reduced. But the economic rents captured by producers can increase, depending on the elasticities of demand and supply, and so the predator profits, and in some circumstances, even the predator's competitors gain.

The raising rivals' costs approach to antitrust analysis is open to serious objection. Some critics charge that it fails to identify anticompetitive practices that would escape condemnation under con-

60. Both of these models predict inefficiently great entry, and that will increase fixed costs in the industry. But fixed costs are not reflected in the short-run industry supply curves.

61. The "raising rivals' costs" analysis has evolved through a number of articles. *See* Salop & Scheffman, *Raising Rivals' Costs*, 73 AMER. ECON. REV. 267 (1983); Krattenmaker & Salop, *Anticompetitive Exclusion:*, *supra* note 4. Krattenmaker & Salop, *Competition and Cooperation in the Market for Exclusionary Rights*, 76 AMER. ECON. REV. 109 (1986); Krattenmaker & Salop, *Analyzing Anticompetitive Exclusion*, 56 ANTITRUST L. J. 71 (1987); Salop & Scheffman, *Cost Raising Strategies*, 36 J. INDUS. ECON. 19 (1987); Ordover, Saloner, & Salop, *Equilibrium Vertical Foreclosure*, 80 AMER. ECON. REV. 127 (1990). The simplest introduction to the analysis is Krattenmaker & Salop, *Exclusion and Antitrust*, 11 REG. 34 (1987).

ventional analysis, such as monopolization under Section 2 of the Sherman Act.[62] Others focus on the stringent economic conditions necessary for the analysis to make sense, and argue that the approach has no practical utility and is unable to distinguish between efficient and anticompetitive practices.[63] For example, a predator will not typically be able to purchase effective monopoly power in an output market from an input supplier at a profitable price because the supplier would often be able to extract any profits available, and disadvantaged rivals would be induced to take countermeasures. Critics also contend that the approach perversely provides firms with an analytical tool for challenging the efficient competitive practices of their rivals.[64]

Raising rivals' costs theory may have more to offer to the study of horizontal arrangements. Suppose some group of professionals is able to secure, at a fixed cost, a restriction on certain activities that has the effect of increasing their competitors' marginal costs, but not their own. For example, suppose one group of dentists does not use dental hygienists, but another does. Use of the hygienists tends to flatten the marginal cost curves of the dentists who employ them. If the dentists who eschew the auxiliaries can manage to ban their use, those dentists will not experience an increase in marginal costs while competing dentists will. The industry supply curve rotates up and to the left, market price rises, and the dentists who secured the ban gain, so long as the fixed costs they incurred are less than the additional rents.

The effects of this scenario are illustrated in Figure 3. With use of hygienists, the supply curve for dental services is S_1. The market price is p_1, output q_1, and the profession earns rents represented by triangle p_1CA. When the ban is imposed, the supply curve rotates up to S_2. Price increases to p_2, quantity drops to q2, and rents are reflected by triangle p_2BA. Rents are greater, as p_2BA is larger than p_1CA. Total welfare drops by the area of triangles BCE and BEA, as well as by the amount of the fixed cost incurred. And notice that

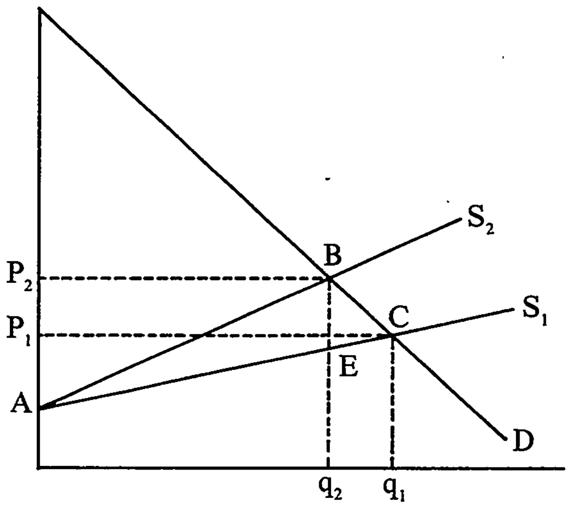
62. 15 U.S.C. § 2 (1988). *See, e.g.*, Brennan, *Understanding "Raising Rivals' Costs,"* 33 ANTITRUST BULL. 95 (1986); Liebeler, *Exclusion and Efficiency*, 11 REG. 34 (1987).

63. *See, e.g.*, Boudreaux, *Turning Back the Antitrust Clock: Nonprice Predation in Theory and Practice*, REG., Fall, 1990, at 45; Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L.J. 305, 314-16 (1987); Lopatka & Godek, *Another Look at ALCOA: Raising Rivals' Costs Does Not Improve the View*, J.L. & Econ. (in press); Claims of Predation in a Competitive Marketplace: When is an Antitrust Response Appropriate?, Remarks of Charles F. Rule, Assistant Attorney General, Antitrust Division, before the 1988 Annual Meeting of the American Bar Association (Aug. 9, 1988); Coate & Kleit, *Exclusion, Collusion, and Confusion: The Limits of Raising Rivals' Costs*, Bureau of Economics, Federal Trade Commission Working Paper No. 179 (Oct. 1990).

64. *See, e.g.*, ANTITRUST IN NEW ZEALAND: THE CASE FOR REFORM 36 (New Zealand Business Roundtable Sept. 1988).

the welfare loss occurs with no change in the demand curve.

FIGURE 3



A discussion of many of the implications of this theory will be saved for the next subsection, which explains a model based on this theory, but one that arguably applies more broadly. For now, two points should be stressed. First, for this theory to work, the output industry supply curve must be upward sloping, at least after the restraint is imposed. Technically, the restraint must make the supply curve more steeply sloped than it would otherwise be. Restraints that prevent a supply curve from becoming flatter, or rotating down and to the right, are as objectionable as those that force the curve to rotate up and to the left. If supply is and remains infinitely elastic, any costs imposed on existing providers will have no impact on price and, therefore, will not generate rents. This also implies that if unrestrained suppliers can quickly expand or enter the market, the restraint on disadvantaged rivals will generate little profit.

The second point is related to the first. The firms seeking the restraint must have the power to affect marginal costs and thereby affect price. The association may consist solely of practitioners whose marginal costs would not be affected by the restraint. In that case, the association would have to possess the legal clout to impose the restraint on non-members, perhaps by securing the assistance of a government agency. If the association has no legal power, then it can only impose the restraint on its members. Membership in the association would need to bestow some significant economic benefit. Moreover, the faction in the association that does not engage in the practice it seeks to restrict may have to defeat a faction that does engage in the practice. This is by no means impossible, but it may be difficult, or costly.

D. *Raising the Marginal Costs of All Suppliers*

Extending raising rivals' costs theory, James Langenfeld and John Morris incorporate the insight of Richard Nelson,[65] and demonstrate that the profits of a group of identical professionals can increase when each professional incurs the same cost increase.[66] Firms can thus increase profits by raising their own costs. This refinement eliminates the need to explain how a group of professionals in an association could have the inclination and power to disadvantage competing professionals in the same association — the theory does not depend upon factions of a group using the group's machinery to injure other factions of the same group.

To understand this model, recall first that an industry supply curve represents the horizontal summation of that part of each firm's marginal cost curve that lies above its average variable cost curve. In the short run, though not necessarily the long run, the industry supply curve is likely to be upward sloping. That is, in a particular finite period, some costs are fixed. Given that fixed cost constraint, marginal costs are likely to increase after some output as volume grows. The profits earned during that period are, consequently, short-run profits, or quasi-rents. An industry has an incentive to maximize short-run profits.

Langenfeld and Morris identify two components of marginal cost: variable cost and incremental cost. In their terminology, a change in variable costs causes a uniform shift in the supply curve; a change in incremental costs causes the supply curve to rotate and thereby change the slope of the supply curve.[67] The intuition behind this dis-

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65. Nelson, *Increased Rents from Increased Costs: A Paradox of Value Theory*, 65 J. POL. ECON. 387 (1957).

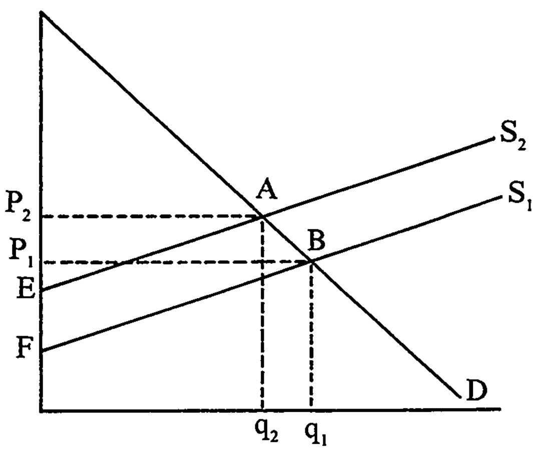
66. Langenfeld & Morris, *Rent Increasing Costs*, *supra* note 16, at 2; Langenfeld & Morris, *Analyzing Agreements*, *supra* note 16. Whether this refinement was overlooked in the earlier raising rivals' costs literature is not entirely clear. The original proponents seemed to recognize that, at least in some vertical contexts, a predator could benefit even when its own marginal costs increased. *See* Krattenmaker & Salop, *Anticompetitive Exclusion*, *supra* note 4, at 238. Krattenmaker & Salop argue that when a predator overbuys an input, the resulting higher price is paid by the predator and its rivals. But "if marginal costs rise faster than average costs, the resulting price increase could benefit all the firms."

67. Langenfeld & Morris, *Rent Increasing Costs*, *supra* note 16, at 5.

tinction is that sometimes a firm's costs increase as output expands, so costs are not fixed, and they increase the same amount for each indivisible unit of output in the relevant range of production. A rise in these costs causes the industry supply curve to rise above and remain parallel to the previous supply curve. During other times, costs can increase as output grows. This increase would be reflected in a counterclockwise rotation of the supply curve.

If variable costs rise needlessly, a deadweight social welfare loss will result, as will a loss in productive efficiency. However, the short-run profits of the producers will also decline. This is illustrated in Figure 4. As an increase in variable costs pushes the supply curve up from S_1 to S_2, price increases from p_1 to p_2, and output declines from q_1 to q_2. Welfare declines, and quasi-rents also decrease, from the area in triangle p_1BF to the area in the smaller triangle p_2AE. Even though a restraint that increased variable costs would reduce welfare, the possibility of such a restraint can be discounted because the producers would have no incentive to effectuate it.

FIGURE 4



An increase in incremental costs is illustrated in Figure 3. The effects on welfare and profits are identical to those described for an anticompetitive increase in rivals' costs. Like that model, this model assumes no change in demand. An increase in incremental costs reduces welfare. However, because it can also increase quasi-rents, depending upon the relevant elasticities of demand and supply, firms may have an incentive to take actions that produce the result. Those actions cannot be ignored.

Langenfeld and Morris use a restriction on advertising, to illustrate a restraint that increases consumer search costs, as an example of a restraint that increases incremental costs.[68] Suppose that in order to sell a small amount of its services a firm of professionals need incur no advertising costs. It opens its doors, turns on the lights, and a certain number of clients just walk in. However, to attract additional clients, the firm begins to advertise. A small amount of advertising will attract a few new clients, but to attract more clients, the firm has to engage in more and more advertising, at higher and higher costs. For simplicity, assume that this is the only marginal cost the firm incurs, and so its marginal cost curve slopes upward.

Now imagine that the firm is precluded from advertising. The restraint has no effect on its costs of acquiring the first few clients, for it was always able to attract those without advertising. But to attract additional clients, the firm now has to substitute some other activity. The activity can be expected to be less efficient, or more costly than advertising, otherwise the firm would have used that method instead of advertising at the outset. Thus, for any given output greater than the initial increment, the firm's marginal cost is higher than it was before the restraint. The firm's marginal cost curve therefore becomes less elastic. Because the model assumes that every firm is identical and incurs the same cost increase, the industry supply curve rotates up and to the left.

The additional rents attract new firms into the industry. As they enter, according to Langenfeld and Morris, the supply curve flattens out, rotating back toward, but not to, its original position.[69] Entry continues until each firm's profits decline to a normal level. This may prompt another round of actions that increase incremental costs, followed by entry. Eventually, the market reaches a new equilibrium, at which suppliers are earning zero profits and so no entry would occur. However, now each firm has artificially high incremental costs, due to the restraint, and produces less than it would produce in a market

68. *See* Langenfeld & Morris, *Rent Increasing Costs*, *supra* note 16, at 16. Other restraints might have a similar effect. For example, restrictions on the use of tradenames, on operating multiple offices, on the permissible location of offices, or on employment by nonprofessionals could be explained as an attempt to increase the incremental costs of supply. See also the 1923 code of the American Institute of Accountants, reported in E. HEERMANCE, *supra* note 18, at 5 ("No member or associate shall allow any person to practice in his name as a public accountant who is not a member or associate of the institute or in partnership with him or in his employ on a salary").

69. If all new firms enter the market burdened by the same restraint that increased the incremental costs of incumbents, it is not clear that entry would cause a clockwise rotation of the short run industry supply curve, or that it would cause any change in the slope of that curve. One would expect, however, that entry would dissipate profits and that the long run equilibrium price in the market would be higher than it otherwise would have been because the firms will be using fixed assets less efficiently.

absent the restraint. The firms agree to the restraint despite the expected entry because of the transitional rents, and they refuse to rescind it to avoid the losses that freeing the now excessive number of firms from the restraint would impose. A sudden elimination of the restriction would drive the supply curve below S_1 in Figure 3, and some firms would be forced out of the market.

The first implication to note about this example, and therefore the model, is that eliminating advertising, by itself, *reduces* costs — advertising is rarely free. Incremental costs increase because some other activity is substituted. If some unrestricted activity is a close economic substitute for advertising, an advertising ban will not increase marginal costs significantly. So if firms are indifferent between advertising and direct mail solicitation, a ban on advertising alone will have no impact on marginal costs. To have an effect, the restraint has to encompass all good substitutes. At the extreme, where all possible substitutes are precluded, the supply curve would become perfectly inelastic, a vertical line, after some increment of volume.

This recognition leads naturally to a comparison of this model and the theory of increasing consumers' search costs. The Langenfeld and Morris explanation assumes that a restriction on advertising imposes on producers the costs of more expensive promotional activities. The search cost model assumes that an advertising ban forces consumers to incur the costs of more expensive, substitute methods of search. The best way to view the matter may be to recognize a demand for information. That demand can be met by suppliers acting to convey information, consumers acting to acquire information, or both. Indeed, consumers typically obtain information as a result of their own efforts as well as those of suppliers. Therefore, an advertising restriction may have little effect on suppliers' marginal costs even if those suppliers have no good alternatives.

Suppose, for example, consumers can acquire information in three ways: suppliers can advertise, suppliers can distribute handbills, and consumers can phone suppliers. Suppose also that advertising is the most efficient way of performing the economic function of imparting information; handbills are a terrible substitute, but telephone inquiry imposes only slightly more social costs than advertising. If an association prohibited advertising, its members would not distribute handbills, and their marginal costs would not increase at relevant levels of output. Consumers would start calling.

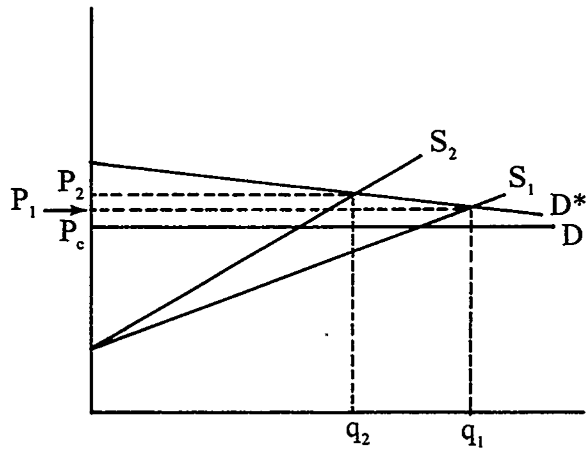
Referring to Figure 3, assume that S_1 and D represent the supply and demand curves when suppliers advertise. Suppliers then stop advertising, and consumers begin phoning. The demand curve would then drop down slightly or rotate slightly, down and to the left. It would intersect S_1 to the left of C. The supply curve would not rotate up — indeed, it might rotate down. At least there would be no change in its slope through q_1. This means that, at least for all quantities that can continue to be economically supplied, marginal costs are no higher. There is nevertheless a small welfare loss as well as a small reduction in quasi-rents. Therefore, for a restriction on information dissemination activities to reduce welfare significantly and generate profits, the restriction must encompass all close substitutes for suppliers. Further, consumers must not have close substitutes for acquiring information.

In addition to the requirement that there be no good substitute for the restrained activity, the costs associated with the economic function performed must represent a significant proportion of total marginal costs. This condition applies equally to the raising rivals' costs model. Suppose that demand is satisfied at an output of around 100 units, and an advertising ban increases marginal costs by about \$5.00. If, at that output, the firm's marginal costs are \$10,000, the increase in cost is trivial, .05%. A trivial increase in incremental costs will produce a trivial change in the supply curve. If instead, total marginal costs increase from \$10.00 to \$15.00, the effect on the supply curve is dramatic.[70] Therefore, an advertising ban may have a very different effect on the supply of tooth extractions than it has on the supply of neurosurgery.

Another implication of this model is that the association must have some form of market power, that is, the members of the association must be facing a downward sloping demand curve. Further, the slope of the demand curve must be significant in order for the association to have significant power over price. Technically, the increase in price brought about by the higher costs must occur where demand is inelastic. Suppose the association faces the demand curve D in Figure 5. A rotation of the supply curve from S_1 to S_2 would have no effect on market price p_c, but would simply reduce the members' profits. The association could increase profits only by reducing costs, say from S_2 to S_1. Even if the demand curve is downward sloping, as is D, a rotation of the supply curve from S_1 to S_2 would produce a huge reduction in output, from q_1 to q_2, but only a slight increase in price, from p_1 to p_2. The cost increase would reduce profits.

70. Krattenmaker and Salop have recognized that the effect of raising rivals' costs of an input on market price and resulting quasi-rents depends on "both the size of the increase and the magnitude of the particular factor of production in the firms' overall costs of doing business." Krattenmaker & Salop, *Anticompetitive Exclusion*, *supra* note 4, at 259.

FIGURE 5



The sources of an association's market power have been discussed previously.[71] To recapitulate briefly, the association has to control any substitutes for its service. If non-members could otherwise provide the same service, the association may be able to secure government action to force non-members to comply with the association's restraints. If membership is an economic necessity for suppliers in the market, the association will not need legal support, but it will have to ensure that its members comply with its rules.

The hypothetical advertising restriction prompts one to ask whether the consumers' search cost theory or one of the suppliers' marginal costs theories is more robust.[72] Under both, the restriction increases price, lowers output, and reduces welfare.[73] A restriction that causes a welfare loss under either theory may be easier to police than would the kind of restriction necessary under the cartel pricing theory. The nature of the market power necessary to increase consumers' search costs differs from that required to increase suppliers'

71. *See supra* notes 34-37 and accompanying text.

72. An advertising restriction can be explained under the pure raising rivals' costs theory, if it has a disparate impact on different suppliers.

73. The source and magnitude of the welfare loss is not identical under both models, however. If consumer search costs are raised, price persists above marginal cost, causing a loss of allocative efficiency, and entry is likely to be excessive. If producers' marginal costs are raised, at no increase in fixed costs, price will drop to the pre-restraint level as entry occurs. Welfare suffers during the interim, when marginal cost is higher than it has to be, and because of the needless entry of resources the restraint provokes.

costs. The number of firms in a market whose advertising must be restricted in order to increase search costs may differ from that necessary to change the slope of the supply curve. Still, market power is a necessary condition under both theories. The observable indicators of an anticompetitive effect such as restraint, market power, price increase, output reduction, and profit increase are the same under both theories. Consequently, the theory a court or antitrust enforcer uses may not matter much. If the supply cost increase theories are more useful, the reason may be that some restrictions have a more apparent impact on supply costs than on search costs.

Finally, under all of the anticompetitive theories, because entry can occur, the profits are short-lived. How short depends on a number of entry conditions, but eventually, profits will succumb. The net benefit of any strategy has to take into account not only the predicted magnitude and life span of the transitional profits, but also the size and likelihood of any losses. An association that creates a restraint through government action runs the risk of losing official support. Members of an association that manage to procure a restraint that disadvantages other members assume the risk that their adversaries will mount a successful counterattack. Further, an antitrust court might ultimately outlaw any anticompetitive restriction. If the restriction is rescinded for any reason after entry has produced a new equilibrium, the profession will suffer losses. How the losses will fall on particular firms is indeterminate, but some firms that had operated before the restraint may well be worse off after it is rescinded. Those potential losses may make firms reluctant to agree to the restraint in the first place, and make an anticompetitive explanation for an observed restraint less persuasive.

E. *Raising the Fixed Costs of New Entrants*

Firms in any industry stand to benefit when fixed costs that the incumbents can and did avoid, are imposed on new entrants. These costs are Stiglerian entry barriers.[74] They do not immediately or automatically affect the market price of the service or the profits of the incumbents. However, they do allow incumbents to raise price above marginal cost with a measure of impunity.[75] If demand increases for exogenous reasons, market price and the profits of incumbents will also increase. Further, the long-run industry supply curve, and hence market price, will almost certainly rise regardless of changes in demand. The firm will profit while the market is moving to the new,

74. *See* G. STIGLER, BARRIERS TO ENTRY, ECONOMIES OF SCALE, AND FIRM SIZE, in the ORGANIZATION OF INDUSTRY 67 (1968).

75. *See generally* Salop & Scheffman, *Raising Rivals' Costs*, *supra* note 61, at 267; Salop & Scheffman, *Cost-Raising Strategies*, *supra* note 61, at 19.

higher equilibrium price, and for as long thereafter as a firm that avoided the additional cost can stay in the market.

Suppose a society of barbers, each of whom had completed a six-week training program, manage to establish a requirement that any new barber must complete a four-year course of graduate studies. Suppose also that the new training has no impact on the quality of haircutting. The education requirement would impose a fixed cost on new barbers that the incumbent barbers never had to incur. This kind of requirement is most likely to occur as a result of government action in the form of a licensing requirement, though it could be imposed privately if the society has an economic source of market power. By the time barbers meeting the education qualification completely displace other barbers in the market, the requirement will no longer generate profits. But the barbers who established the restraint will have profited from it, and it will continue to impose needless social costs. Therefore, there is an anticompetitive explanation for the action.[76]

F. Collusively Manipulating Demand

The anticompetitive theories discussed so far involve manipulating costs or pricing above marginal cost. Welfare can also be affected by actions that change demand and do not result in prices above marginal cost. Joint actions that only increase demand are assumed to increase consumer welfare. However, an agreement to disseminate false information that increases demand could arguably reduce welfare, though welfare could not be calculated simply by objective reference to demand curves. Further, any normative valuation of demand would be fraught with difficulty. In the context of professional rules, it is more likely that members of an association might agree to suppress accurate information, which if learned, would reduce the

76. The anticompetitive explanations discussed in the text involve effects in the market for professional services. Professionals also function as purchasers of inputs to provide those services. A professional rule could reduce welfare by restraining purchases in the input market. In other words, a rule could turn the association into a monopsony cartel. In such a case, the price paid for the input and the quantity purchased are less than a competitive buyers' market would produce. For example, employees of professional firms are likely to be a significant input. Given the right conditions, a rule that forbids competition among members for employees could have monopsonistic effects. Basically, the skills of the employee would have to be so specialized that he earns significantly more in one job than he would in any other. Further, the parties to the agreement would need to have market power with respect to that job. For a general discussion of the necessary conditions for and effects of monopsony, see D. CARLTON & J. PERLOFF, *supra* note 29, at 114-17.

demand for professional services. For the same reasons that an agreement to disseminate false information might reduce welfare, an agreement to withhold truthful information could arguably also produce that effect. Conduct that impermissibly results in greater demand than would otherwise exist is usually the subject of consumer protection laws, such as laws against false advertising.[77] Whether the objectionable conduct is the product of joint or unilateral action is largely an economic detail. Consumer protection laws can apply to both kinds of actions, whereas the antitrust laws typically cannot. However, in appropriate cases the practice could be analyzed under the antitrust laws.

For example, suppose an association's rule prohibits members from disclosing any information that would adversely affect the reputation of another member.[78] The information restrained by such a rule might have no effect on the demand for professional services, but merely cause a shift in the pattern of supply among professionals. Yet the rule might reduce the aggregate amount of negative information about the profession supplied to consumers, information that would have caused consumers to lose confidence in a profession, and consequently caused market demand to drop.[79] Such a rule could also reduce the negative externalities that would flow from an

77. *E.g.*, the Federal Trade Commission Act, § 5, 15 U.S.C. § 45 (1988), prohibits "unfair or deceptive acts or practices in or affecting commerce."

78. Rules that prohibit members from disparaging the services of another member or another professional are commonplace in associations' codes of ethics. *See, e.g.*, the rules of the following associations: American Dental Association, *reprinted in* E. HEERMANCE, *supra* note 18, at 143 (1923 version) and in J. CLAPP, *supra* note 18, at 227 (1972 version); International Secret Service Association, *reprinted in* E. HEERMANCE, *supra* note 18, at 145 (date of version not disclosed); National Association of Real Estate Boards, *reprinted in id.* at 452 (1924 version) and the National Association of Realtors, *reprinted in* J. CLAPP, *supra* note 18, at 676 (1962 version); National Funeral Directors Association of the United States, *reprinted in* E. HEERMANCE, *supra* note 18, at 517 (1919 version); National Auctioneers Association, *reprinted in* J. CLAPP, *supra* note 18, at 111 (1949 version); American Association of Marriage and Family Counselors, *id.* at 432 (1962 version). The potential effect of professional criticism in at least some contexts was suggested in the 1970 rules of the American Optometric Association: "When an optometrist succeeds another optometrist in the charge of a case, he should not make comments on, or insinuations regarding the practice of the one who preceded him. Such comments or insinuations *tend to lower the esteem of the patient for the optometric profession* and so react against the critic." *Reprinted in* J. CLAPP, *id.* at 517 (emphasis added).

79. A rule that prohibits the dissemination of truthful, critical information about a competitor could be viewed as one that increases the incremental costs of members. *See supra* notes 65-70 and accompanying text. If the least costly way of attracting additional clients is to inform them that their chosen professionals are somehow inferior, the rule could force members to substitute more expensive activities to increase output. This explanation is not wholly convincing, however, because the inherent effect of disclosing negative information is to eliminate the practitioner to whom it relates from the market. The total elimination of competitors from the market is likely to have a more dramatic effect on the supply curve, a more favorable effect on the profits of remaining professionals, than is a collective decision to increase the incremental costs of all suppliers.

individual's decision to disclose information that reflects badly on the profession, but nevertheless lead to an efficiency loss. In practice, determining that such a rule is likely to reduce welfare would be difficult. Making an economically relevant determination as to whether information is "true" or "false" could prove intractable. Further, a rule that restrained the dissemination of only false or misleading information about a competitor would not even arguably reduce welfare.[80] Indeed, a rule that prevented demand from dropping by restraining the dissemination of false information would increase welfare.[81] Nonetheless, the theoretical possibility of a welfare-reducing rule of this kind should be acknowledged.

80. Several associations have adopted rules that only prohibit the dissemination of false or malicious information about competitors. *See, e.g.*, the rules of the following associations: American Institute of Architects, *reprinted in* E. HEERMANCE, *supra* note 18, at 23 (1922 version); American Institute of Consulting Engineers, reported *id.* at 166 (1921 version); American Society of Civil Engineers, reported *id.* at 170 (1914 version); American Society of Appraisers, *reprinted in* J. CLAPP, *supra* note 18, at 63 (1968 version).

81. Welfare can also be enhanced by rules that require members to disclose information about the incompetence of another professional. *See, e.g.*, the code of the Board for Certification of Genealogists, *reprinted in* J. CLAPP, *supra* note 18, at 323 ("I will . . . participate in exposing genealogical charlatans.") (date of version not disclosed); the code of the American Physical Therapy Association, reported *id.* at 562 ("The physical therapist should accept responsibility for exposing incompetence . . . to the appropriate authority") (1969 version).

In some situations, the dissemination of critical, though truthful, information about competitors could conceivably injure the consumer in a way unrelated to the general perception of the profession. In such a case, a rule prohibiting disparagement could arguably increase consumer welfare. For example, the American Medical Association code recognized that telling a patient disparaging information about his or her physician's treatment could interfere with that treatment to the detriment of the patient. See E. HEERMANCE, *supra* note 18, at 343 (1912 version). This rationale was suggested, yet questioned by an English author:

> [O]ne of the cardinal rules [of etiquette for physicians] was to make certain that the patient knew of no difference of opinion that might arise in consultation. No doubt that was good for the patient's peace of mind, but was that the only consideration? "I was dining at the Duke of Richmond's one day last winter," wrote the physician Thomas Young about 1800, "and there came in two notes, one from Sir W. Farquhar, and the other from Dr[.] Hunter, in answer to an inquiry whether or no His Grace might venture to eat fruit pies or strawberries. I trembled for the honour of the profession, and could not conceal my apprehensions from the company: luckily, however, they agreed tolerably well, the only difference of opinion being on the subject of the pie-crust.

W. READER, *supra* note 14, at 19 (footnote omitted). This efficiency enhancing argument is founded on paternalism, however. It assumes that consumers can be made worse off by giving them truthful information. This is a flimsy basis on which to restrain the dissemination of information.

IV. Welfare-Enhancing Theories of Professional Rules

In order for an ethical restraint to be justified as efficiency-enhancing, it obviously must produce an increase in economic welfare. Each of the anticompetitive theories described predicts a loss in total welfare as well as a loss in consumer welfare. A restraint might increase total welfare at the same time it reduces consumer surplus, if producer gains outweigh consumer losses. This article assumes that to constitute an antitrust violation, any class of restraints must first of all reduce total welfare.[82]

Moreover, because the ethical rules under review are at least in part a product of voluntary actions of private suppliers, no welfare-enhancing theory will be considered plausible unless the restriction increases the profits of the association. It is conceivable that a group of altruistic professionals would agree to some restraint that benefits consumers but reduces their own profits. (Only a very odd group indeed would effectuate a restraint that harmed both themselves and consumers). However, such an altruistic restraint conflicts with fundamental assumptions of rational economic behavior, and that kind of motivation could not explain many restraints in any event. Slightly more plausible, yet equally devoid of analytical interest, is the rare restraint that increases consumer welfare but has no effect on profits.

Finally, some ethical rules affect neither consumer welfare nor producer surplus. If a small society of veterinarians wanted to admit only graduates of the University of Illinois, the membership restriction would have no impact on demand or supply in the market for professional services. Technically, the qualification would presumably have some positive utility associated with it or the association

82. Many commentators over the years have argued that the antitrust laws have non-economic underpinnings and that they should promote social and political values. Other commentators have argued that the antitrust laws serve the economic goal of protecting consumer welfare, so that a practice that increases total welfare but reduces consumer surplus should violate the antitrust laws. *See, e.g.*, Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213 (1985); Lande, *The Rise and (Coming) Fall of Efficiency as the Ruler of Antitrust*, 33 ANTITRUST BULL. 429 (1988). Although these arguments are not convincing, the restraints identified in this Article as welfare-enhancing typically would not result in any diminution in consumer surplus, at least they would not necessarily do so.

In some circumstances, when a restraint reduces consumer surplus but increases producer surplus more than a compensating amount, it may be preferable to impose antitrust liability and set a penalty that does not deter the restraint, than to refuse to find a violation. *See* Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652 (1983). When a kind of restraint, such as an agreement to restrict output, almost always reduces welfare, it may be efficient to condemn all instances of the restraint. This would be true even if the restraint sometimes increases welfare and even if the antitrust penalty is set too high, so that the activity is deterred. This essentially is the justification for a rule of *per se* illegality. *See infra* notes 118-21 and accompanying text. These points do not affect the analysis in this Article.

would not adopt it. While welfare-neutral restraints are of little interest to the analysis in this Article, their undoubted existence underscores an important principle: Agreements should not violate the antitrust laws unless they cause anticompetitive harm. The burden is on the prosecution.

In general, an ethical rule can increase welfare by either lowering costs or increasing demand. The following subsections elaborate the necessary conditions for each method. The first explores changes in marginal costs that do not affect demand. The second addresses changes in demand brought about by activities that alter costs.

A. Lowering the Marginal Costs of Supply

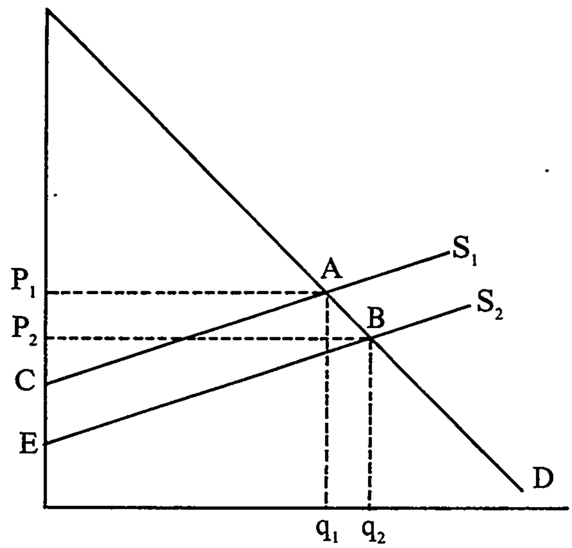
If an association has no market power, any size reduction in any kind of marginal cost always increases welfare. Market price and consumer surplus would not change, but producer surplus would increase. For example, in Figure 5, suppose the association, beginning at supply curve S_2 with demand D, agreed to a restraint that reduced incremental costs. The supply curve would rotate down and to the right, to S_1. The members' profits would increase, price would stay p_c, and welfare would grow. If the restraint reduced variable costs, the supply curve would shift down and to the right, and the same results would hold, except profits would increase even more.

The more intriguing task is to identify the kinds of reductions in marginal costs that will be profitable and increase welfare when the association has market power.[83] First, a reduction in variable costs continues to be welfare-enhancing and profitable, assuming demand is not perfectly inelastic. In Figure 6, the reduction in variable costs shifts the supply curve from S_1 to S_2. Price drops from p_1 to p_2, output increases from q_1 to q_2, and profits increase from the area in triangle p_1AC to the area in triangle p_2BE. Second, a reduction in incremental costs limited to the early stages of output would result in a rotation of the supply curve in a counterclockwise direction from the point at which it intersects with the demand curve. In other

83. An agreement simply to restrain production of some product by firms with market power can be efficient when the private marginal costs incurred by each producer do not in the aggregate reflect total, or social marginal costs. In other words, the production decisions of each firm may impose externalities on others. The classic presentation of this possibility was made by Professor Knight using the example of the cost of traffic congestion as a highway becomes overused. *See* Knight, *Some Fallacies in the Interpretation of Social Cost*, 38 Q. J. ECON. 582, 585 (1924). The insight can be generalized, and has been applied, for example, to production from a common pool. *See* Landes, *supra* note 82, at 658.

words, the marginal cost of selling the last unit of output does not change, so price and output are unaffected. But profits and welfare increase because of the savings in marginal costs for the first increments of production. Third, an agreement that reduced the marginal costs of producing intermediate units of output would increase profits. The Langenfeld and Morris model, for simplicity, assumes that the supply curve is a straight line. If this assumption is relaxed, one can imagine a supply curve that, as a result of some restraint, exhibits an outward bulge in the middle, reflecting lower costs for intermediate levels of output, but identical costs for early and late volumes.

FIGURE 6



The only kind of reduction in marginal costs that would not appear to increase profits would be the reverse of the cost rise that increases profits, that is, a reduction in incremental costs at high levels of output. This would cause a rotation in the supply curve in a clockwise direction from its origin. But appearances can be deceiving. Although this kind of a change would reduce profits if price equals marginal cost, it will likely increase profits if price is determined by marginal revenue. Thus, for example, if the association fixes price through an agreement other than the restraint in question, even a restraint that causes a clockwise rotation of the supply curve would increase profits.

Or suppose that the industry begins in a monopolistically competitive equilibrium. Price is above marginal cost, but because of entry, the average total cost curve is tangent to the demand curve at that price. Profits are zero. Now a restraint is established that causes the marginal cost curve to rotate down and to the right, and the average total cost curve to drop down at most output levels. Technically, the marginal cost curve would not be a straight line in such a situation, and so the downward rotation would take on a different appearance from that depicted in previous illustrations. Still, the new marginal cost curve would be coincident with the old curve at their origins and lie below it at later points. Price is determined by the intersection of marginal revenue and the new marginal cost curve. Price is lower, and quantity is higher. But at that output, price is above average total cost, and so the firm earns profits. The market is not in equilibrium — it will attract entry, which will eliminate the profits. But the restraint generates profits, so the firms have an incentive to agree to it. Consumer surplus increases as well. Of course, in a monopolistically competitive market, any of the other kinds of cost reductions would also be profitable.

These examples illustrate the effects of various kinds of reductions in marginal costs in different market structures, as well as the effects of cost reductions when positing different modes of behavior, under the assumption of a static demand. However, suppose that this demand assumption is relaxed. Suppose in a market where price is determined by marginal cost, a restraint lowers marginal costs somewhere along the associated curve, but not where the curve intersects demand. Correspondingly, in a market where price is determined by marginal revenue, the restraint would reduce marginal costs for some outputs less than the output dictated by the intersection of marginal cost and marginal revenue, but not the output associated with that intersection. However, as output expands, the restraint results in higher marginal costs. As long as demand remains constant, the restraint produces no change in price but does increase profits and welfare. The effect on marginal costs at levels of output in excess of the amount sold is irrelevant.

Now assume, however, that for reasons unrelated to the restriction, the demand curve shifts or rotates outward. Whether price continues to be determined by marginal cost or marginal revenue, it will now be higher and output lower than if the restraint did not exist. This poses both static and dynamic problems. If the marginal deadweight loss, measured by the two possible supply curves given the new demand, is less than the cost savings produced by the restriction, the restriction would continue to increase welfare. However, if the deadweight loss exceeds these savings, maintaining the restriction would reduce welfare. Nevertheless, whether the net effect of the restriction is welfare-reducing depends upon the durations of the periods of welfare gain and welfare loss, as well as the magnitude of the effects. In theory, a restraint can increase welfare initially but reduce welfare later. Thus, when inter-temporal changes in demand are taken into account, the net effect of a restraint on economic welfare can be negative. This problem would disappear if the association eliminated the restraint when demand increased. But such a change could reduce the profits of the association, for the reasons discussed earlier, and therefore the association would be deterred from making it.

Therefore, even if a restriction would have an immediate positive effect on welfare, it could arguably be condemned on the ground that the restriction would reduce welfare if demand grows and it is not rescinded. In short, the argument is that the restraint is likely to have a net negative effect. The argument is not compelling. It depends upon estimates of future demand — that demand will increase, perhaps substantially, and not thereafter shrink — and upon a prediction that the restriction will not erode for exogenous reasons. Further, it implies a willingness to trade-off what are assumed to be certain immediate gains for speculative distant losses.

The purpose of this discussion was to provide a theoretical analysis of the ways in which a restraint could be profitable and increase welfare by reducing marginal costs, not to identify association rules that would have the described effects. It is clear that no professional rule can be justified on this basis unless the supposed cost savings would not be realized absent the rule. In other words, one has to conclude that competition among unrestricted professionals would result in higher marginal costs.

With this in mind, a few examples can be hypothesized. A rule that association members must submit disputes among themselves to arbitration might lower the marginal costs of dispute resolution.[84] An association might impose an ethical obligation to refer clients to other members who, for reasons of practice specialty or geographic location, are better suited to provide the services needed. The reciprocal nature of the obligation might induce beneficial reallocations of clients more efficiently than would a system of direct referral payments, which might be separately prohibited anyway.

Another potential cost-saving rule is a prohibition on one member hiring employees of another.[85] Employees may be privy to confidential, commercially significant information, such as customer lists. Moreover, identifying prospective employees and training them both in general skills and in the idiosyncrasies of a particular employer's

84. Dispute resolution provisions have historically been a common feature of association codes. Indeed, one historian reports that "provisions for settling disputes without recourse to the law . . . have their precedents in Saxon gilds . . . ." G. UNWIN, THE GILDS AND COMPANIES OF LONDON 53 (1938).

85. The codes of many associations contain restrictions on hiring other members' employees. See, for example, the rules of the following associations: American Institute of Accountants, *reprinted in* E. HEERMANCE, *supra* note 18, at 6 (1923 version); National Association of Real Estate Boards, *reprinted in id.* 452 (1924 version) and National Association of Realtors, *reprinted in* J. CLAPP, *supra* note 18, at 676 (1962 version); National Auctioneers Association, reported *id.* at 111 (1949 version).

practice are likely to require an investment by the employer, and other professionals can free ride on much of that investment. A so-called "anti-pirating" rule can allow members to reduce the variable costs of maintaining trade secrets and of training employees when establishing and enforcing contractual obligations on the part of each employee is a more costly alternative.

Finally, a restriction on the hours of operation has been offered as an example of a restraint that raises incremental costs.[86] If a group of car dealers agree to be closed evenings and weekends, the marginal costs of selling cars may increase because more expensive activities would have to be substituted to sell those cars that would have been purchased by consumers at convenient times. But suppose barbers in a town agree to be closed on Wednesday afternoons. The market is characterized by monopolistic competition with free entry, and so each shop, and the industry as a whole, has excess capacity. Absent the restriction, some consumers would choose Wednesday afternoon to be shorn, but the inconvenience of selecting another time has a trivial effect at least on the marginal consumer. Such a restriction might have no effect on the marginal costs of providing initial numbers of haircuts and reduce the marginal costs of providing intermediate numbers. Yet, the restriction would increase the costs of numbers that exceed current demand, assuming that operating Wednesday afternoon would be the cheapest way to provide additional haircuts. It would therefore allow existing facilities to be used more efficiently to satisfy current demand.[87]

B. *Increasing Demand*

Suppliers' actions that increase the demand for a service typically impose costs on the suppliers. Suppliers would have no interest in incurring avoidable costs to increase demand unless the increase more than compensates them for the additional costs. Therefore, an action taken to increase demand may increase profits and welfare. However, as William Comanor has pointed out in another context, suppliers can increase profits by increasing the demand of the marginal consumer even when the demand-inducing action is not valued

86. *See* Langenfeld & Morris, *Analyzing Agreements*, *supra* note 16. For a different argument that agreements restricting hours of operation should be illegal, see R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 85-86 (1978). Such an agreement was found unlawful by the Federal Trade Commission in Detroit Auto Dealers Ass'n, 111 F.T.C. 417, 499 (1989).

87. A rule that may fall somewhere between the apparently anticompetitive restriction discussed by Langenfeld and Morris and the apparently procompetitive one hypothesized in this Article is a rule tentatively adopted by the American Optometric Association in 1924. The restriction provided, "It is unethical and forbidden to keep open office or place of business on national holidays, State holidays, or Sundays." *See* E. HEERMANCE, *supra* note 18, at 400.

by the infra-marginal consumer.[88] The shape of the demand curve changes. In such a case, the action can increase profits but reduce welfare. Though this is undoubtedly true in theory, it is nearly impossible to determine empirically that an action increasing demand at the margin had no effect on infra-marginal demand.[89] For this reason, a marginal increase in demand that exceeds a marginal increase in cost will be assumed to increase welfare, unless otherwise noted.

Any action that increases the demand for a service can be viewed as increasing the quality of the service. In general, quality can be enhanced by actions that increase fixed costs or variable costs; "variable costs" for present purposes means any costs that vary with output in the reasonably short run. The classic example of a fixed cost is the investment necessary to qualify for and secure a license to practice. The traditional economic justification for licensing requirements is based on a presumed asymmetry of information between the provider and consumer of services.[90] Suppose consumers are unable to evaluate the quality of professional services even after they are rendered. An unsuccessful litigant does not know whether the lawyer was incompetent or the case was weak; a patient does not know whether the illness persisted because it was misdiagnosed by the doctor or because the disease was incurable. Consumers are therefore willing to pay for the average quality of services available, because they cannot discern below and above average performance. Suppliers, on the other hand, are not willing to incur the costs necessary to provide services of above average quality because they will not be able to recoup the investment. Indeed, suppliers have an incentive to provide substandard services, for they will earn a premium at prices determined by average quality. Therefore, the quality of services in the market, spirals downward, and the lower quality of services re-

88. Comanor's insight addressed the practice of resale price maintenance. Comanor, *Vertical Price Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983 (1985).

89. *See, e.g.*, P. IPPOLITO, RESALE PRICE MAINTENANCE: ECONOMIC EVIDENCE FROM LITIGATION, 23 Bureau of Economics Staff Report, Fed'l Trade Comm'n (April 1988).

90. Other justifications for licensing exist. For example, transactions between suppliers and consumers may impose negative externalities. A physician who fails to cure a contagious disease may cause an epidemic. In such a case, even a consumer with perfect information about the quality of the physician might not be willing to pay for the optimal level of competence because the prospective private loss is far smaller than the possible social loss. This is an economic argument. By contrast, one could argue paternalistically that consumers simply should not be permitted to purchase certain kinds of services, such as medical care, that are below a prescribed level of quality.

sults in a dampening of demand. This market failure has been dubbed the "lemon" phenomenon.[91]

One response to the lemon problem is to require government permission, or a license, to provide services and establish licensing standards that ensure that providers meet a desired level of competence. Thus, individuals who graduate from medical school would typically provide better care than those with no professional training. The investments required to satisfy licensure requirements, such as four years' tuition, would raise the long-run industry supply curve and market prices. But if demand increased sufficiently as a result, total welfare would increase. This is not to say, of course, that licensing does increase welfare, only that it could.

Licensure, by definition, requires governmental action—it is the government granting authority to practice a profession.[92] Therefore, licensure is not usually associated with a private organization's code of ethics. However, the government can establish a general scheme of licensure, or particular licensure requirements, at the behest of an association.[93] To the extent that an eligibility requirement is the product of private and governmental action, it is no different from a restriction on conduct specified in an ethical code and thereafter adopted by a government entity. Conceivably an association might establish an eligibility requirement that increased total welfare yet left profits unaffected. As noted above, such an altruistic motive is an unlikely explanation for behavior. Eschewing that explanation, though, does not inexorably lead to the conclusion that any eligibility requirement adopted at the behest of a private association has an anticompetitive effect. The imposition of a new requirement is likely

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91. There is significant literature examining the proposition that asymmetric information may cause market failure and reduce the quality of products available. *See, e.g.*, Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970); Leland, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality-Standards*, 87 J. POL. ECON. 1328 (1979); Leland, *Minimum Quality Standards and Licensing in Markets with Asymmetric Information*, in OCCUPATIONAL LICENSURE AND REGULATION (S. Rottenberg ed. 1979); Schmalensee, *A Model of Advertising and Product Quality*, 86 *J. Pol. Econ.* 485 (1978); Smallwood & Conlisk, *Product Quality in Markets Where Consumers Are Imperfectly Informed*, 93 Q. J. ECON. 1 (1979); Stuart, *Consumer Protection in Markets with Informationally Weak Buyers*, 12 BELL J. ECON. 562 (1981).

92. I adopt here the traditional definitions of licensure, certification, and registration. Licensure means that a practitioner is legally prohibited from providing services without permission granted by a government authority. Certification means that any practitioner can offer services, but only an individual meeting prescribed standards and approved by a certifying agency, government or private, can claim to be certified or use specified titles. Registration implies that all practitioners must notify a government authority that they are providing services. Notification requirements are generally minimal, however, and registration has little commercial significance. *See* S. YOUNG, *supra* note 15, at 5.

93. Indeed, a government theoretically could delegate to an association the right to establish licensing standards for an entire profession.

to generate short-run profits for incumbent suppliers whether the requirement increases or decreases total welfare, that is, whether it pushes the demand curve out sufficiently to offset the higher costs or has no effect on demand. The fact that a rent-seeking group of professionals secured a licensure requirement does not prove that the requirement is inefficient.

An association can impose eligibility requirements for membership that are not adopted by the government as conditions for licensure. A state, for example, might require all physicians to hold medical degrees, but a society of surgeons might require a surgical residency to join. A private eligibility requirement can raise the quality of the services the association's members provide. That is, the quality of the services the hypothetical society renders may be higher if the members have completed surgical residencies than if they have not. Notice that when a private group or a government entity uses an eligibility requirement to raise the quality of services provided, the requirement generally serves as a surrogate measure of quality. In contrast, a consumer may derive more utility from receiving services from a professional who possesses a certain credential, such as a Harvard diploma, than from one who does not, even if the services provided are objectively identical. To that extent, the credential would be a direct measure of quality because it increases demand by itself. However, eligibility requirements are typically used because they are positively correlated to the quality of services provided; fulfillment of the eligibility requirement can be determined with relative ease, and directly assessing the quality of services provided by the practitioner is difficult.

The essence of the market failure that might justify a government-imposed eligibility requirement is an informational asymmetry. This is the same condition that can lead to a welfare-enhancing private eligibility requirement.[94] Suppose the cost to consumers of evaluating the quality of professional services is very high. An association

94. Asymmetric information in a market is not limited to professional services, and it is not a recent phenomenon. In 1408, knife-making in London was divided into three crafts: the bladesmiths, who made the blade; the cutlers, who fitted the handle; and the sheathers, who supplied the sheath. The cutlers sold the finished product. They complained that "the blame and scandal of bad workmanship" fell upon them, particularly the faulty work of the sheathers. In other words, consumers did not have the information to distinguish among the three trades, and so the deficient work of one trade imposed negative externalities on another. In response, the cutlers were granted authority "to institute a scrutiny, along with two master sheathers, of all sheaths made in England or sold in London." G. UNWIN, INDUSTRIAL ORGANIZATION IN THE SIXTEENTH AND SEVENTEENTH CENTURIES 24-25 (1904).

could assess quality and represent to consumers that its members provide high quality services. Membership in the association then becomes a relatively cheap signal of quality to consumers, a device that lowers the cost of acquiring information about quality. It becomes a certification, like a trademark or servicemark.

Of course, the association itself is assessing quality through eligibility requirements that are mere surrogates. The consumer might be able to employ the same surrogates without the aid of the association. But determining what the appropriate surrogates are is likely to be more costly for consumers than for the society of experts. Does completion of a residency in general surgery bear upon an oral surgeon's ability to reconstruct a jaw? Further, some surrogates may be generated independently by the association. For example, the association may devise an examination or conduct a training program. Finally, the association is likely to use a cluster of eligibility requirements. The consumer can more easily determine the single fact of association membership rather than whether the practitioner satisfies each of the criteria the association would have used.

Recall that no association's rules can have an adverse impact on welfare unless the association has market power. If eligibility requirements are purely private, the association cannot have derived power through government action. In that case, the association must use its own economic power to force enough professionals to meet eligibility requirements so that market price is affected. However, even if an association can and does force the entire profession to join and comply with its eligibility requirements, it will not necessarily be acting anticompetitively. If the source of the market power is the eligibility requirements themselves, it is not anticompetitive to force suppliers who wish to take advantage of the demand created by the eligibility requirements to comply with them. Thus, in order for eligibility requirements to be welfare-reducing, they must either be adopted by the state or be imposed by an association that professionals must join for essential economic benefits unrelated to the requirements themselves.[95]

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95. A group of firms may agree to embark on a risky new venture. A restriction among the venturers may not be necessary to achieve the static productive efficiencies inherent in the enterprise but may nonetheless generate short-run profits. The venture's economic power therefore may be independent of the restriction. But if the possibility of monopoly rents was the catalyst for undertaking the joint venture, the restriction cannot be eliminated without deterring future, efficient joint arrangements. To that extent, anticompetitive rules that do not form the basis of an association's market power in a static sense cannot be attacked with impunity, for they may be efficient in a dynamic sense.

If an association has market power unrelated to a particular restriction and not a product of law, one would expect competing associations to be formed that do not impose the anticompetitive rule. Some have argued that new associations will not be able to arise because of economies of scale. *See* Langenfeld & Morris, *Analyzing Agreements*, *supra* note 16. It is not clear, however, exactly what functions an association performs that are

If an association does turn to the state to impose its eligibility requirements on an entire profession, is the inference inescapable that the requirements reduce welfare? The answer is no. As explained above, a rent-seeking group of suppliers can benefit from the imposition of licensing requirements even when those requirements increase welfare. But if demand is enhanced when services are provided by suppliers who satisfy eligibility requirements, should not the association be content merely to impose them on its own members and allow non-members — uncertified professionals — to charge less for their services, which consumers value less? The anticompetitive explanation for enlisting government aid is that by increasing the long-run marginal costs and hence the price charged for services of non-members, the residual demand for members' services, which are to some degree substitutable, increases.

There is another explanation, however. Certification is intellectual property. Those who possess certification possess something of value only to the extent that others can be excluded. It is fundamentally like any other kind of property. Those who would invest in creating a certification mechanism, in informing consumers of the certification's meaning, and in becoming certified will not do so unless their investments can be recouped.[96] A farmer will not invest in growing corn unless he can prevent others from taking his crop. In other words, the investor must be able to prevent free riding. Free riding is prevented, which is to say that property rights are protected, generally by resort to the common law. An owner sues an infringer for theft of the property right. However, resort to the courts imposes private costs on the plaintiff. Those costs mount as the existence of the property right and the fact of infringement become more difficult to prove, and consequently, as the frequency of infringement increases.

When tangible property is stolen, ownership and theft are relatively easy to prove. As the probability of apprehension and the penalty increase, the incidence of theft will decline. The professional as-

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subject to economies of scale. Consequently, it is also unclear whether any diseconomies would be substantial enough to permit an association to maintain a rule which has a significant anticompetitive effect. Associations undoubtedly supply information, and because information is a public good, there are scale economies in its provision. But the free-rider problems inherent in the provision of a public good did not prevent the association from forming to begin with. It is not clear why those problems would prevent competing associations from being formed. Certainly many professions have more than one association.

96. For general discussions of the economics of property rights, see R. POSNER, *supra* note 7, at 29-33; R. COOTER & T. ULEN, *supra* note 7, at 99-149 (1988); ECONOMIC FOUNDATIONS OF PROPERTY LAW *supra* note 7; De Alessi, *supra* note 7.

sociation is not as favorably positioned to protect its property right in its certification. Suppose the American Society of Engineers establishes costly eligibility requirements for membership, and consumers are willing to pay more for the services of members. Competing professionals form the American Academy of Engineers and impose trivial membership requirements. If consumers do not distinguish between the associations, Academy members will be able to charge the same prices that Society members charge — and free ride on the investments of the Society. Although the Society may sue the Academy, it will not succeed unless a court finds that the Society had a common law or statutory property right that was infringed by the Academy. In the process, the Society will have incurred litigation costs. In the case hypothesized, whether a legal right has been infringed is by no means clear, because the Academy did use a different name. And even if the Society wins, the remedy may only be an injunction prohibiting future use of the name. This kind of penalty is not likely to have deterred the Academy in the first place. It would be akin to telling the thief that if he is caught, he will have to give back the booty.

One option the Society has is to create the public perception that it is different from and better than the Academy. But creating this perception will be costly. The Society will have to distinguish itself not only from the Academy, but possibly from other newly formed organizations as well — the College and the Association. Indeed, the more successful its efforts, the more valuable its certification will become and the greater the incentive for others to free ride. The task of differentiating its certification will be difficult if differences in names and insignia are subtle and because the nature of professional services tends to prevent consumers from quickly assessing the quality of the services rendered.[97] The task will be even more difficult if consumers react negatively to an association's efforts to promote its certification. In all, establishing a valuable public perception of a professional certification will be expensive. And maintaining that value by prosecuting infringers will also be costly.[98]

The private costs of establishing property rights within the legal

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97. The problem of distinguishing indicia of certification is not new. In 1408, bladesmiths in London complained to the mayor that "country makers were in the habit of selling blades with trademarks resembling their own to the cutlers," who assembled finished knives. In response, "an arrangement was made under which the cutlers agreed not to take such wares, and the bladesmiths were bound not to increase the price of blades except by advice of the two masters of each craft jointly." G. UNWIN, INDUSTRIAL ORGANIZATION, *supra* note 94, at 25. It is not clear whether the cutlers themselves were misled by the country makers' trademark or were searching for the best price.

98. For a discussion of the significance of the costs of policing property rights, see Demsetz, *The Exchange and Enforcement of Property Rights*, 7 J. LAW & ECON. 11, 16-26 (1964).

system, and of enforcing those rights, may become so high that a would-be owner cannot economically incur them. Where intellectual property is concerned, the legal system may be particularly undeveloped; regardless of the potential value of recognizing those rights, the cost of defining them is very high.[99] If an association cannot economically protect itself from free riding, it may never be formed. Potential members would pursue the next best alternative of avoiding the investments that would increase demand but could not be recovered.

Alternatively, the association might attempt to escape private costs by enlisting the aid of the government. If the state investigated and prosecuted infringements, as the police and state's attorney might respond to the theft of tangible property, the association could reduce its costs of *maintaining* the value of its certification. But in fact there is little public enforcement of rights in private certification. Indeed, public enforcement is impossible to the extent that the legal system does not recognize the underlying property rights. Moreover, the association would not avoid the costs of *creating* the value of its certification. The government could respond by adopting the private eligibility requirements as requirements for government certification.[100] Those property rights are more likely to be recognized, and the government would be likely to enforce them, so that the private association would avoid some costs. Still, the public costs of government certification might be high. The government might

99. Professor Demsetz, one of the pioneers in the exploration of property rights, has argued that property rights are created when the value of having them, determined by the demand for the underlying subject of the right, exceeds the costs of defining them. *See* Demsetz, *Toward a Theory of Property Rights*, 57 AMER. ECON. REV. 347 (1967). He applies this thesis to explain the development of property rights among certain North American Indian tribes. Where the burgeoning fur trade made rights in hunting territories valuable and the forest terrain made defining those rights feasible, rights were established. They were not established among the Southwestern Plains Indians at that time because those tribes lived among no animals of commercial significance. Therefore the costs of defining hunting rights in the plains was high.

100. In effect, private certification standards were adopted as public certification requirements when the Apothecaries Act became law in England in 1815. That Act gave the Society of Apothecaries the right to determine who could use the title "apothecary" by establishing education requirements and proficiency exams.

> [T]he act gave the Society power to prevent unqualified persons from calling themselves apothecaries anywhere in England or Wales. These powers were quite unprecedented at the time. Both Royal Colleges [of Physicians and of Surgeons] were examining bodies, but the Surgeons had no power to prevent anyone from calling himself a surgeon, qualified or not, and even the august Physicians' authority, founded on a Royal Charter, only extended to London and the district seven miles about.

W. READER, *supra* note 19, at 51.

instead respond by imposing the association's eligibility requirements on the entire profession and thereafter policing its licensure mandate. The association might nevertheless have an interest in promoting the value of the profession, but it would not have to distinguish its members from other professionals in the market.

This discussion is not meant to suggest that the government should impose licensure requirements, require public certification, or police rights in private certification.[101] Nor is it intended to demonstrate that an association would always prefer state-imposed requirements to its own efforts to create and maintain private certification. An association may benefit more from distinguishing its members from other suppliers in the market, despite the private costs incurred and the residual free riding, than from operating in a market of undifferentiated, high quality providers. Rather, the discussion is meant to demonstrate that an association's appeal for state help does not prove that the eligibility requirements reduce welfare. Eligibility requirements may increase welfare, and a private certification mechanism may be the most efficient way of ensuring that the value-increasing investments are made. But if the private association can avoid costs by procuring government assistance, it may try to secure that help. In that event, the association would solicit government aid not to increase costs of supply or demand, since it could accomplish the latter by private certification. Rather, the association would seek the government's help in order to reduce its own marginal costs of maintaining the value of its certification. All that is needed is positive, avoidable costs associated with private certification, and those are virtually certain to exist.[102]

To summarize, eligibility requirements imposed by a government through a licensure system can (not will) increase welfare by correcting a market failure caused by asymmetric information. A private association may adopt eligibility requirements in response to the same kind of information failure. Membership acts to certify the quality of the services provided. The requirements must increase demand for the services of members. In order for the requirements to serve a certification function, consumers must be cognizant of and place a value on membership, though the association need not neces-

101. As a matter of economic policy, certification, whether public or private, may generally be preferable to licensure. If the impetus for regulation of any form is imperfect information, the narrowest regulatory response may have the least social cost. In a world of perfect information, certification would allow those consumers who were unwilling to pay for high quality service the opportunity to purchase low quality service. That opportunity would be denied under a licensure system, which would exclude low quality suppliers from the market. Whether certification is economically a better policy depends on the costs of operating a reasonably effective certification system.

102. Indeed, an association may risk antitrust liability and treble damages for attempting to protect a property right in certification.

sarily promote actively the significance of membership.[103] If the association has no market power unrelated to its eligibility requirements, the requirements will increase welfare. Even if the association has such economic power, the requirements may increase welfare. Moreover, the association may solicit and secure government assistance in imposing welfare-enhancing restraints on the industry when avoiding the potentially infinite private costs of establishing and maintaining property rights in certification is profitable.

Compliance with eligibility requirements, as the term is used here, imposes fixed costs on professionals. The term "conduct restriction" is used here to identify rules that impose variable costs on professionals. Conduct restrictions include both prohibitions on engaging in specified activities and commands to engage in specified conduct. Rules that regulate the behavior of professionals as they provide services will inherently affect the marginal costs of supply. In fact, most ethical rules, as commonly understood, govern the conduct of eligible professionals.

Conduct restrictions, because they affect marginal costs, are susceptible to the anticompetitive explanations discussed above based on raising marginal costs.[104] However, they are capable of increasing welfare in essentially the same way and for the same reasons as eligibility requirements. Like eligibility requirements, they can enhance quality, or increase demand. They can do so directly, if the conduct induced is itself valued, or indirectly, if that conduct is perceived as signalling high quality services. Consumer welfare may increase if an association can reduce the search costs of locating suppliers who adhere to a set of conduct restrictions. However, all of the problems associated with certification discussed in the context of eligibility requirements apply with full force here.[105]

Conduct restrictions that shift the short-run supply curve up, and

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103. Some associations do in fact explicitly encourage members to promote the associations' insignia. *See, e.g.*, the Principles of Professional Conduct and Ethics of the American Society of Travel Agents, *reprinted in* J. CLAPP, *supra* note 18, at 765 (1971 version) ("ASTA Members should use advertising materials to acquaint the public with the advantages to be gained through the use of the ASTA Travel Agent.").

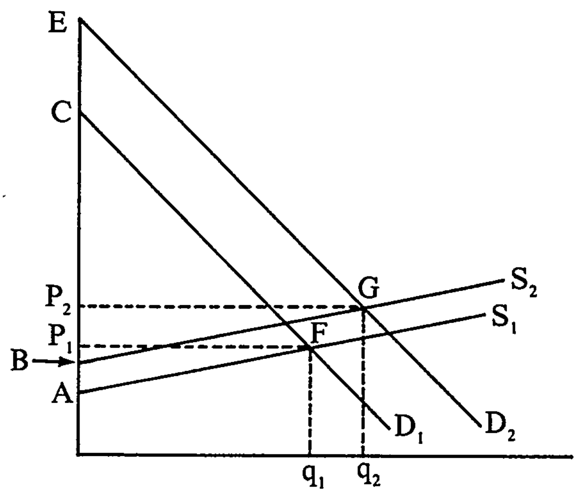
104. *See supra* notes 61-73 and accompanying text.

105. Carr and Mathewson argue that, in response to asymmetric information, law partnerships, as opposed to solo practices, are formed so that the firm can internally monitor the services provided to clients and deter chiseling, thereby protecting the capital investment in the firm's brand name. Carr & Mathewson, *The Economics of Law Firms: A Study in the Legal Organization of the Firm*, 33 J. L. & ECON. 307 (1990). Their argument is consistent with the theory set out in this section. The quality of legal services increases as chiseling is deterred.

increase variable costs, in the terminology of Langenfeld and Morris, will increase welfare if the restrictions push the demand curve out sufficiently far. An association will profit from them only if welfare increases. Conduct restrictions that force the supply curve to rotate counterclockwise from its origin,[106] that increase incremental costs, can generate quasi-rents even when they do not affect demand. Conduct restrictions that increase incremental costs can nevertheless increase total welfare, but only when they increase demand enough so that the resulting sum of consumer and producer surplus exceeds the previous total. Unlike an increase in variable costs, an increase in incremental costs that does increase demand may be profitable even though economic welfare declines.

An example of a demand-increasing restraint that also causes an upward shift in marginal costs is illustrated in Figure 7. Absent the restraint, the demand and supply curves are D_1 and S_1, respectively. Price is p_1, quantity is q_1, consumer surplus is triangle CFp_1, and producer surplus is p_1FA. When the restraint is imposed, the supply curve shifts up to S_2, the demand curve shifts out to D_2, price increases to p_2, and quantity increases to q_2. Consumer surplus increases to EGp_2, and producer surplus increases to p_2GB. Economic welfare increases because the sum of consumer and producer surplus increases from area CFA to the larger area BEG.

FIGURE 7



As is evident from the discussion of eligibility requirements, a conduct restriction generally can increase demand only if it satisfies two

106. *See supra* note 67 and accompanying text.

conditions. First, the restriction must induce conduct that is more valuable to consumers than the conduct that would otherwise occur. Second, embodying the restriction in an association's rule must be efficient for some reason, either because it reduces the costs of inducing the desirable behavior or because it reduces the consumers' search costs of locating desirable practitioners.

The value-increasing nature of the conduct induced can sometimes be easily identified. For example, suppose an association's rule prohibits a member from simultaneously representing clients with adverse interests without their consent.[107] Engaging in that kind of representation obviously could result in impaired services being rendered to one of the clients. So too, a rule that prohibits members from disclosing a client's confidential information[108] would inherently increase the value of the services rendered by protecting clients from the personal or commercial injury that such disclosure could

107. Rules designed to insulate the professional from financial incentives to offer advice contrary to the best interests of the client are perhaps the most common in association codes. Rules explicitly restricting the ability of members to render services to clients with conflicting interests include those of the following associations: American Institute of Electrical Engineers, *reprinted* in E. HEERMANCE, *supra* note 18, at 167 (1912 version); American Bar Association, *reprinted in id.* at 280 (1908 version); American Institute of Architects, *reprinted in* J. CLAPP, *supra* note 18, at 92 (1972 version); Financial Analysts Federation and Institute of Chartered Financial Analysts, *reprinted in id.* at 305 (1969 version); American Society of Landscape Architects, *reprinted in id.* at 398 (1962 version).

Other rules, apparently designed to protect professional judgment from compromising financial incentives, are those that prohibit a professional from accepting commissions from non-professionals for using or recommending their services and from paying commissions to or accepting commissions from other professionals for referrals. A few of the associations with rules of this kind are the following: American Institute of Accountants, *reprinted in* E. HEERMANCE, *id.* at 5 (1923 version); American Institute of Architects, *reprinted in id.* at 22 (1922 version); American Dental Association, *reprinted in id.* at 143 (1923 version) and in J. CLAPP, *supra* note 18, at 227 (1972 version); American Society of Heating and Ventilating Engineers (1921 version), American Society of Mechanical Engineers (1922 version), Society of Naval Architects and Marine Engineers (1923 version), *reprinted in,* E. HEERMANCE, *supra* note 18, at 164; American Medical Association, *reprinted in, id.* at 345 (1912 version) and in J. CLAPP, *supra* note 18, at 565 (date of version undisclosed); American Pharmaceutical Association, *reprinted in,* E. HEERMANCE, *supra* note 18, at 422 (1922 version) and in J. CLAPP, *supra* note 18, at 554 (1969 version); Society of Real Estate Appraisers, *reprinted in,* J. CLAPP, *id.* at 71 (1971 version); American Osteopathic Association, *reprinted in id.* at 576 (1965 version); American Psychological Association, *reprinted in, id.* at 631 (1963 version).

108. Associations with rules of this kind include the following: National Society of Professional Engineers, *reprinted in,* J. CLAPP, *supra* note 18, at 254 (1971 version); American Medical Association, *reprinted in, id.* at 565 (date of version not disclosed); National Society of Interior Designers, *reprinted in, id.* at 388 (date of version not disclosed); American Association of Marriage and Family Counselors, *reprinted in, id.* at 432 (1962 version); American Nurses' Association, *repinted in, id.* at 485 (1968 version); American Psychological Association, *reprinted in id.* at 628 (1963 version).

cause.[109]

However, the nature of other restrictions may be more subtle. Suppose a rule prohibits members from soliciting a client while some actual or potential employment relationship exists between the client and another member.[110] Depending on the parameters of the rule, it could increase consumer search costs. The rule could also reduce consumer search costs, and otherwise increase demand, by creating a private system of property rights in activities designed to identify and secure clients. Professionals make investments to obtain clients. They will not be compensated for those client-specific costs that are incurred prior to the time the prospective client assumes an obligation to pay. To the extent that a competing professional could obtain the client before the obligation attaches, the probability of receiving compensation declines, the amount of investment that is justified by

109. An interesting example of a rule that could be explained as an attempt to deter demand-reducing behavior or a device to increase marginal costs of supply is a ban on the use of contingency fees. See the 1923 Rules of Professional Conduct of the American Institute of Accountants, *reprinted in*, E. HEERMANCE, *supra* note 18, at 6, and the 1973 rules of its successor organization, the American Institute of Certified Public Accountants, *reprinted in*, J. CLAPP, *supra* note 18, at 11. Use of a contingency fee arrangement will create an incentive for the professional to reach the result that will maximize her compensation, whether or not that result imposes costs on third parties. For example, investors may rely upon the auditing services of an accountant provided to a firm, or a government agency may rely upon a tax return or proposal for funds prepared by the accountant. If the accountant is induced to provide inferior work because of the contingency arrangement, the value of accounting services will decline. An association may want to certify that its members do not engage in the deleterious practice in order to reduce the search costs of locating high quality practitioners. Moreover, if inferior work later causes serious harm, the reputation of the entire profession may suffer. An association may want to avoid the negative externality that it would suffer as a result of a nonmember's action.

On the other hand, if the use of contingency fee arrangements is an efficient method of attracting clients, who would not otherwise retain the professional, a prohibition may increase the incremental costs of all suppliers or the marginal costs of a subgroup, such as new entrants. Methods of determining what effect a restriction has are discussed in the last section of the Article.

110. Rules that restrict solicitation of another's client or customer are common among associations and take many forms. Some rules prohibit attempts to supplant a competing member after "definite steps" have been taken toward employment. See, for example, the rules of the following associations: American Institute of Architects, *reprinted in*, E. HEERMANCE, *supra* note 18, at 23 (1922 version); American Institute of Consulting Engineers, *reprinted in*, *id.* at 166 (1921 version); American Congress on Surveying and Mapping, *reprinted in*, J. CLAPP, *supra* note 18, at 748 (1959 version). Others prohibit solicitation after another member has been engaged by or has entered into a contract with the client. See, for example, the rules of the following associations: American Society of Appraisers, *reprinted in*, *id.* at 63 (1968 version); Board for Certification of Genealogists, *reprinted in*, *id.* at 323 (date of version not disclosed); American Institute of Interior Designers, *reprinted in*, *id.* at 384 (date of version not disclosed); American Society of Landscape Architects, *reprinted in id.* at 400 (1962 version). Still other rules constitute general bans. *See, e.g.*, American Institute of Accountants, *reprinted in* E. HEERMANCE, *supra* note 18, at 6 (1923 version). And others prescribe rather elaborate restrictions. *See, e.g.*, National Association of Real Estate Boards, *reprinted in id.* at 452 (1924 version).

the expected compensation drops, and the services to the prospective client diminish. Moreover, if a competing professional can free ride on another's investment in locating a client, the level of that investment will decline.

Consider again the ban on advertising. Suppose consumers derive more utility from physicians who do not advertise than from those who do. Economics takes personal tastes as a given. For whatever reason, these consumers derive positive utility from receiving services from professionals who do not advertise, just as they might prefer pickled beets to filet mignon. Some consumers may even use the fact of advertising as a surrogate for assessing the quality of the services offered. They reason that good physicians do not advertise. The possibility that advertising can cause disutility is not far-fetched. Professions have historically cultivated the impression that their members do not offer services primarily for pecuniary gain. Professionals offer services to promote the public good, and if they earn a living wage in the process, so much the better. A host of restrictions can follow from this premise, such as that a professional must provide free services to an indigent person in need of help.[111] Advertising may suggest that the professional is motivated by commercial gain. Consumers may believe that practitioners interested principally in commercial success will not provide the quality of services that others offer.

Now the argument may be true only because the profession made it true by inducing the perception. Although members of a profession may be no less motivated to pursue profits than used car dealers, if consumers believe they receive better services from public-spirited professionals, they do. In this respect, a profession will have nurtured a valuable perception, just as a myriad of commercial enterprises

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111. *See, e.g.*, The Principles of Medical Ethics of the American Medical Association, adopted 1912, *reprinted in*, E. HEERMANCE, *supra* note 18, at 345 (The "poverty of a patient and the mutual professional obligation of physicians should command the gratuitous services of a physician."); the Code of Ethics of the American Osteopathic Association, adopted 1904, *id.* at 354 ("[P]overty . . . should always be recognized as presenting [a] valid claim[] for gratuitous services."); and the Code of Ethics of the American Chiropractic Association, adopted in 1971, *reprinted in*, J. CLAPP, *supra* note 18, at 166 ("[P]overty, . . . (and) the poorly remunerated occupation of some individual patient . . . should be recognized as presenting valid claims for gratuitous services.").

Perhaps the most striking example, or maybe the most lurid, of an obligation to serve the public interest at personal sacrifice is contained in the 1919 Code of Ethics of the National Funeral Directors Association of the United States, *reprinted in* E. HEERMANCE, *supra* note 18, at 517. A provision states, "No funeral director, in case of epidemic or contagious disease, should shirk his professional duties, even though his life may be in jeopardy." *Id.*

have generated valuable consumer impressions through advertising. A beer company that trumpets its contributions to a clean water fund may stimulate sales to environment-conscious consumers. An electric utility may generate valuable good will by telling consumers to conserve energy. An automobile manufacturer may profit by creating the impression that sexy people drive its cars.

One might respond that this argument proves too much. Any commercial enterprise can claim that an advertising ban will increase value. But in fact, consumers may not react in the same way to advertising by different suppliers. Consumers expect car dealers to advertise, and they presumably would not be willing to pay any more to a dealer who did not. That simply may not be true for cardiologists. One might also argue that professionals should be prevented from fostering a misimpression — if professionals are not allowed to prohibit advertising, they will advertise, and consumers will come to expect professionals to advertise. But this would deny a profession the value of the impression it has already cultivated, as it would condemn any advertiser for reaping profits from a favorable illusion that it conjured up. It would also impair consumer sovereignty by dictating the permissible sources of utility.

A welfare-enhancing explanation of conduct restrictions requires more than a showing that consumers value the conduct the restrictions are designed to induce. Embodying the behavioral dictates in association rules must also be efficient. Rules may be necessary largely because of the reduction in search costs associated with certification.[112] If a number of activities combine to affect the overall quality of the services rendered, a consumer might be able to assess the quality of a provider by discerning certification more cheaply than by evaluating each element of conduct. The certification will continue to be useful only if the association ensures that members comply with the restrictions. Consumers therefore identify association membership with quality service, whether or not the association actively promotes the perception.

Suppose an association prescribes a number of conduct restrictions that increase demand. Members charge a higher price to cover the higher costs of higher quality services. Other professionals will want to charge the same prices for inferior services, and so the association will have to deny membership to them to preserve the value of the certification. These denied competitors may allege that exclusion from the association is anticompetitive, arguing that the ability of association members to charge higher prices proves that the association has market power. Collectively denying competitors the ability to charge higher prices because they do not provide the quality of

112. *See supra* notes 94-95 and accompanying text.

service that warrants those prices can violate no intelligible principle of antitrust law. Still, antitrust enforcement is imperfect, and denial is risky. Further, because the association would like to avoid some of the costs of policing its rules it enlists the aid of the state.

If preserving the value of certification is the objective, one might conclude that the association would only be justified in soliciting assistance to enforce deception laws or coincident government certification. But this assumes that certification can be established and protected economically. In fact, no certification, public or private, is perfect or free. The actions of non-certified professionals may impose negative externalities on their certified competitors. For example, consumers may associate the injury-producing conduct of one non-certified accountant with all accountants. They may generalize, rather than reasoning that their experiences and observations of disreputable conduct by non-certified practitioners has no bearing on the expected quality of the services of certified professionals. The incident might instead increase the value of certification, and the association would surely have an incentive to disassociate itself from the culprit and emphasize to consumers the importance of membership.[113] However, certification may not protect high quality professionals from being injured by the actions of others, and in any event it will be expensive and become more so as it becomes more successful.[114]

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113. The negative externalities associated with disreputable conduct by some members of a profession reportedly led to the creation of the "Realtor" trademark and a national code of ethics for real estate brokers who belonged to the forerunner of the National Association of Realtors. The term was coined by a past president of the Minneapolis Real Estate Board. On his way to a board meeting, he saw a newspaper with the headline, "Real Estate Man Swindles a Poor Widow." The culprit was not a member of the local board, yet he had "besmirched" every broker in the city. The official suggested adopting a title that would single out members and imply that the board vouched for them as qualified and responsible. The term "Realtor" was chosen. *See* P. DAVIES, REAL ESTATE IN AMERICAN HISTORY 110-114 (1958).

Similarly, unrespectable conduct by some attorneys, as opposed to barristers, in eighteenth-century England purportedly convinced "reputable members of the profession that they would never get their claims to higher standing taken seriously unless they actively discountenanced and deterred disgraceful practices." In or before 1739, therefore, they founded in London "a voluntary professional association, the Society of Gentlemen Practisers in the Courts of Law and Equity, commonly called the Law Society, and one of its principal objects was to clean up attorneys' practice." W. READER, *supra* note 14, at 28.

114. One association tried to capture the essence of negative and positive externalities generated by professional conduct, and found that one cliche simply would not do: "*The professional landscape architect acts and practices always in a manner bringing credit to the honor and dignity of the profession of landscape architecture.* . . . This is a broad recognition of the principle that 'one bad apple spoils the barrel' and the principle that a group of people in the same boat should pull together." The Code of Professional

If certification is economically infeasible, an association may have to choose between functioning in an undifferentiated market with high or low average quality. The quasi-rent of professionals as well as consumer welfare may be greater at the high-quality equilibrium. The association might therefore privately attempt to ensure the quality of services offered by the profession generally or, more likely, petition the government to adopt its conduct restrictions as mandatory rules of behavior for all professionals. This is the lemon problem first addressed by private action through conduct restrictions when certification is impossible.[115] In this case, the conduct restrictions of an association, whether or not ratified or independently adopted by a government entity, could increase welfare even though they do not serve to distinguish association members from other professionals.

If a state does adopt the association's restrictions as rules for licensure, or even for government certification, the association will not necessarily abandon them. The association might even adopt common law rules as its own. An association may be the most effective enforcer of these mandates. If certification is effectively impossible, the association may nevertheless have an interest in raising the quality of services provided in the market. If certification is feasible, the association's interest may be stronger. For example, though professionals may be prohibited from having conflicts of interests by the common law, statute, or administrative regulation, some professionals will undoubtedly violate the prohibition. An association may provide consumers with valuable information by in effect certifying that its members obey the law. In a market of suppliers that contains an array of quality, an association may usefully distinguish itself even when providing low quality services is illegal. The association would become irrelevant only if compliance with the law were perfect.[116]

Practice of the American Society of Landscape Architects, 1962 edition, *reprinted in*, J. CLAPP, *supra* note 18, at 397.

115. *See supra* note 91 and accompanying text.

116. The source of the legal requirement is not, however, economically insignificant. The capture theory suggests an anticompetitive explanation for legislation and administrative regulation — that such government action is procured at the behest of rent-seeking producers to achieve anticompetitive ends. See authorities cited in note 2, *supra*. By contrast, the common law is generally presumed, at least by scholars in the law and economics movement, to be driven by an intuitive desire to increase efficiency. *See, e.g.*, R. POSNER, *supra* note 7, at 20-22. *See generally* Rubin, *Why Is the Common Law Efficient*, 6 J. LEGAL STUD. 51 (1977); Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Goodman, *An Economic Theory of the Evolution of the Common Law*, 7 J. LEGAL STUD. 393 (1978); R. COOTER & T. ULEN, *supra* note 7, at 492-96. If an association enforces a statute or regulation, it may be attempting to perfect the anticompetitive purpose and effect of the measure. If it enforces a common law mandate, however, no analogous anticompetitive explanation exists.

The distinction between the likely effects of government action has led William Page, in an excellent article, to articulate a theory of state action immunity that distinguishes between legislative and administrative policies. *See* Page, *Interest Groups, Antitrust, and*

This analysis does not purport to prove that the eligibility requirements and conduct restrictions of professional associations increase welfare, only to explain why they might. If association members can charge higher prices solely because compliance with the rules of the association increases demand, those rules do presumptively increase welfare. The possibility that rules enhance welfare is not negated if the association imposes them through an exercise of unrelated economic power or procures government support. Nor is that possibility negated if the association maintains rules that are embodied in legal mandates.

V. APPLICATION OF THEORIES TO FACTS

If the effects of any given rule on the costs of supplying services and the demand for those services could be measured directly with precision, confidence, and ease, determining candidates for antitrust condemnation would be simple. Anticompetitive rules cause prices to rise and output to fall; procompetitive rules typically cause prices and output to increase or leave both unaffected. Any rule whose net effect was to reduce welfare would be a target. All that would remain to be done to establish an antitrust violation would be to prove an agreement, identify the parties to it, and then apply the doctrine of state action immunity.[117] Even a rule that both increased the marginal costs of supply and increased demand could be judged without risk of error. A *per se* rule would be irrelevant, for the errors of overinclusion implicit in such a rule could not be justified either by significant savings in litigation costs or by eliminating errors of underinclusion.

The demand and supply effects of professional rules, however, can hardly ever be ascertained at trivial cost. Marginal costs are notoriously difficult to calculate. Prices can often be observed and demand can be measured, but the data necessary to determine the effect of a rule, perhaps decades old, are often unavailable. Because of the usual difficulty of direct measurement, rational antitrust enforcement may hinge upon identifying principles of analysis that can be applied at low cost and produce reasonably accurate predictions of the effects of rules. Several principles are possible, and they lead to different possible antitrust rules.

State Regulation: Parker v. Brown in the Economic Theory of Legislation, 1987 DUKE L. J. 618, 632-37 (1987).

117. Section 1 of the Sherman Antitrust Act outlaws "[e]very contract, combination . . ., or conspiracy" in restraint of trade. 15 U.S.C. § 1.

A. Possible Antitrust Rules

1. Categoric illegality

One principle might be that if a single rule of a particular association is proven empirically to reduce welfare, all of the rules of that association would be conclusively presumed to be anticompetitive. In most cases such a principle would be expensive to apply. A definitive study of even one rule would likely be substantial. Although it might reduce the costs of analysis significantly, it would also be misguided. There is no basis for assuming that all of an association's rules produce the same effects. Indeed, a typical association has an array of rules, some of which can be explained by no intelligible anticompetitive theory. Similarly, concluding that all of an association's rules enhance efficiency because one has been proven to do so would have little better justification. Such a principle would create an incentive for an association with market power to surround an anticompetitive restraint with welfare-enhancing rules.

A more promising principle would hold that if a particular rule of a given association is proven empirically to reduce welfare, that rule will be conclusively presumed to be anticompetitive when imposed by any association. That is the essence of the *per se* rule.[118] The great practical benefit of the *per se* rule is that it abrogates the need to prove a net reduction of welfare or even of market power. This is not because *per se* illegal practices reduce welfare even when the actors have no market power. Rather, the rule has been justified on the ground that long experience with a practice can demonstrate that it is almost always undertaken by actors who have market power and it decreases welfare.[119] When this is so, a *per se* rule can reduce the

118. Perhaps the classic statement of the *per se* rule is contained in Northern Pacific Railway v. United States, 356 U.S. 1, 5 (1958): "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."

119. This experiential foundation for the *per se* rule is best demonstrated by White Motor Co. v. United States, 372 U.S. 253 (1963). The Court there refused to find vertical customer and territorial restrictions illegal *per se*. *Id.* at 263. Referring to the territorial restraints, the Court said:

> We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. They may be too dangerous to sanction or they may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business . . . . We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a "pernicious effect on competition and lack . . . any redeeming virtue" . . . and therefore should be classified as *per se* violations of the Sherman Act.

Id. (citations omitted). However, the Court has not consistently cited experience as the basis for *per se* illegality. For example, the Court held a boycott illegal *per se* in Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 (1959), because it interfered with costs of litigation and of erroneous failure to impose liability for anticompetitive practices, while creating little risk of overinclusion.[120]

The premise of the *per se* rule, is that a given practice has a predictable anticompetitive effect.[121] Practices that constitute explicit or

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the "freedom of traders." For an interesting discussion of the bases of the *per se* rule, see Krattenmaker, *Per Se Violations in Antitrust Law: Confusing Offenses with Defenses*, 77 GEO. L. J. 165, 167-70 (1988).

120. In Federal Trade Commission v. Superior Court Trial Lawyers Association, 110 S. Ct. 768 (1990), the Court articulated a rationale for the *per se* rule that is misleading, if not wrong. The Court likened antitrust *per se* rules to *per se* restrictions on "stunt flying in congested areas or speeding." *Id.* at 781. The Court observed that "every speeder and every stunt pilot poses some threat to the community," and commented, "An unpredictable event may overwhelm the skills of the best driver or pilot, even when the proposed course of conduct was entirely prudent when initiated." *Id.* The Court reasoned, "So it is with boycotts and price fixing. Every such horizontal arrangement among competitors poses some threat to the free market. A small participant in the market is, obviously, less likely to cause persistent damage than a large participant. . . . [H]owever, a small conspirator may be able to impede competition over some period of time. Given an appropriate set of circumstances and some luck, the period can be long enough to inflict real injury upon particular consumers or competitors." *Id.* (footnotes omitted).

If certain conduct can only cause harm, and the only question is how much, *per se* condemnation of that conduct can only increase welfare, whether by a lot or a little. The reference to stunt flying and speeding conjures up colorful images of activities that have no obvious social benefit. The Court noted that perhaps most violations of laws against those activities "actually cause no harm" *id.*; it did not add, "and produce some benefit." In fact, activities presumably increase the utility of the actors, but that is not an effect that leaps to mind. By contrast, conduct subsumed in the categories of antitrust *per se* illegality do increase welfare. The decision, then, is not whether to condemn automatically activity that is only likely to do a little harm, but whether to condemn activity that will affirmatively do good. The Court's discussion of the *per se* rule in Arizona v. Maricopa County Medical Society, 457 U.S. 332, 344 (1982), seems to recognize this analysis and is therefore more ingenuous. *See infra* note 188. Moreover, the immediacy of the danger in the context of stunt flying and speeding is simply not comparable to any danger posed by price fixing given a market structure that prevents an anticompetitive effect. A child is more likely to wander into the street than ten shoe manufacturers are to exit the market.

121. The danger in applying a *per se* rule to the restriction of a professional association when the anticompetitive effect of the restriction is unclear from the evidence in the case and experience elsewhere was nicely summarized by Judge Posner in Vogel v. American Society of Appraisers, 744 F.2d 598 (7th Cir. 1984). The case involved a rule of the American Society of Appraisers that prohibited a member from doing "work for a fixed percentage of the amount of value . . . which he determines at the conclusion of his work." *Id.* at 599. Judge Posner wrote:

> [T]he novelty of the challenged practice (novel to the courts, that is) is a reason against *per se* classification. . . . The attempt to get rid of the fixed-percentage appraisal fee may be perniciously anticompetitive in ways that we cannot perceive from the scanty record before us, but to condemn it before any evidence on its competitive effects has been produced would prevent the courts from acquiring any information about it. It is difficult enough for judges to inform themselves about business practices without shutting off the information flow before it begins, by prematurely adopting a rule of blanket illegality.

Id. at 603-04 (citations omitted).

implicit agreements to charge stipulated prices in excess of marginal cost, to limit output so that prices rise to that level, or to divide territories so that each resulting local monopolist charges prices at that level have been the kind most likely to be condemned *per se*. Logically, however, practices that almost always produce any of the other anticompetitive effects set out earlier, like an increase in consumer search costs or in the marginal costs of supply, equally warrant *per se* condemnation. As discussed below, the Court has applied something akin to a *per se* rule to a practice that at most had such an effect.

The classic practice that produces the traditional anticompetitive effect is an agreement among competitors as to specific prices charged. That kind of an agreement could be, and has been, embodied in the rules of a professional association. The Supreme Court held such an agreement illegal *per se*.[122] If the universe of contexts in which price fixing has occurred is considered to be the whole of economic activity, application of the *per se* rule might well be efficient.[123] After all, the process of defining a category of *per se* illegal-

122. In United States v. National Association of Real Estate Boards, 339 U.S. 485, 488 (1950), the Court held that a local real estate board, by adopting standard rates of commissions and an ethical rule that provided, "Brokers should maintain the standard rates of commission adopted by the board and no business should be solicited at lower rates," even though the rule was enforced by no sanction, committed a *per se* antitrust violation. In Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975), the Court held illegal an agreement embodied in bar association rules to adhere to a fee schedule for common legal services. However, it is not clear whether the Court found the agreement illegal under the *per se* rule or the rule of reason. The Court nowhere used the term "*per se*." It did say in a footnote:

> The fact that a *restraint* operates upon a profession as distinguished from a business is, of course, relevant in determining whether that *particular restraint* violates the Sherman Act. It would be unrealistic to view the practice of professions as interchangeable with other business activities, and automatically to apply to the professions antitrust concepts which originated in other areas. The public service aspect, and other features of the professions, may require that a *particular practice*, which could properly be viewed a violation of the Sherman Act in another context, be treated differently. We intimate no view on any other *situation* than the one with which we are confronted today.

Id. at 788 n.17 (emphasis added).

In a later case, the Court explained that the footnote meant that "certain practices by members of a learned profession might survive scrutiny under the Rule of Reason even though they would be viewed as a [*per se*] violation of the Sherman Act in another context." National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 686 (1978). Whether the Court was referring to "certain practices" *other than* agreements to charge specified prices or *including* such agreements is not clear. The best interpretation is that the Court in *Goldfarb* found the arrangement illegal under the rule of reason but that explicit price fixing thereafter was *per se* illegal. Other practices, however, might be judged under the rule of reason even though they are illegal in non-professional settings.

123. At times, the Supreme Court has implied that explicit price fixing agreements will be assessed in relation to the whole of economic activity and not in relation to subcategories. For example, in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 222 (1940), the Court said that "the Sherman Act, so far as price-fixing agreements are concerned, establishes one uniform rule applicable to all industries alike." Similarly, in

ity is the art of deciding what elements of conduct and attributes of market structure will be ignored. However, if the universe is limited to professional associations, the justification for the rule is less compelling. Explicit price fixing provisions in association rules are rare. They were the subject of *National Association of Real Estate Boards*, which involved associations of real estate brokers, and *Goldfarb*, which involved bar associations, and in both cases the organizations may have had market power.

The 1922 rules of the American Institute of Architects (hereinafter "Institute") similarly provided that the "proper minimum charge" for professional services "is six per cent."[124] But the Institute at the time comprised 30 percent of the profession.[125] Whether that association had market power is doubtful. Market power could be conferred by state regulation, but there is no reason to suspect that the six percent rate for architecture services was mandated by law. Alternatively, suppliers who account for a large percentage of a properly-defined antitrust market can have the power to raise price. Thirty percent of a market would fall far short, but that assumes the market consisted of all architects.

Defining professional services' markets can be difficult. *The Justice Department Merger Guidelines* define a market as

> a product or group of products and a geographic area in which it is sold such that a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a 'small but significant and nontransitory' increase in price above prevailing or likely future levels.[126]

National Society of Professional Engineers v. United States, 435 U.S. 679, 689 (1978), a case involving a professional association's rule that prohibited competitive bidding, the Court said, "The early cases . . . foreclose the argument that because of the special characteristics of a particular industry, monopolistic arrangements will better promote trade and commerce than competition." The Court cited United States v. Trans-Missouri Freight Association, 166 U.S. 290 (1897), and United States v. Joint Traffic Association, 171 U.S. 505, 573-77 (1898).

Yet in NCAA v. Board of Regents of the University of Oklahoma, 468 U.S. 85, 101 (1984), the Court refused to apply the *per se* rule to an agreement that governed the sale of television rights to college football games, even though the *per se* rule appeared to be appropriate under the Court's analysis, because the case involved "an industry in which horizontal restraints on competition are essential if the product is to be available at all." It is probably safe to say that the Court in the last decade has become more willing to distinguish among industries in applying the *per se* rule. The limits of that willingness are not clear.

124. *See* E. HEERMANCE, *supra* note 18, at 20.

125. *See* B. LANDIS, *supra* note 17, at 13.

126. *See* Justice Dep't Merger Guidelines, [Jan.-June] Antitrust & Trade Reg. Rep. (BNA) No. 1169, at S-1 (June 14, 1984).

The services of members of a given profession are not fungible. It may be that some segment of a profession could raise price profitably, that is, without causing demand or supply responses that would thwart the increase, and so that segment would constitute a relevant antitrust market.[127] In the case of the architects, it is possible that the members of the Institute accounted for a much larger share of a smaller market, a market comprising less than the whole profession. Estimates that Institute members did "more than half and perhaps three-fourths of the architectural business in the country" tend to support that possibility.[128] Of course, non-member architects surely were at least a looming presence on the fringe of whatever the relevant market was, poised to expand into the market if attracted by monopoly profits.

If the market embraced all architects, a price increase could not have had an anticompetitive effect. Consumers would have switched to non-member architects, who could have increased their output at little increase in marginal cost. For this reason, any cartel wants to bring within its scope as large a fraction of the suppliers in a market as possible. Yet the Institute was criticized by members and non-members for its exclusivity — for setting up "a small 'clique' within the profession" through use of "high standards of admission", thereby failing "to carry along with it the great majority of architects of the country."[129]

Even an association whose members account for a large share of a market cannot always increase price with impunity. The participants in any cartel have a strong incentive to cheat on the agreement. To sustain anticompetitive prices for an appreciable period of time, the association would have to be able to detect chiselling, a potentially nettlesome task in light of the nature of professional services, and it would need the ability to impose an effective deterrent. If expulsion from the association is the ultimate sanction, membership in it must afford a significant commercial advantage.[130] Further, when service competition cannot be restrained, even an airtight price restriction will generate little profit, for available rents will quickly be dissipated in the provision of better services.

The Institute may not have had power to raise price above marginal cost. But if that is so, what explains the minimum price rule? It could be that the rule was not enforced, which in the language of

127. It is also possible, and perhaps more likely, that the antitrust market extends beyond the boundaries of a traditional profession. For example, a properly defined market for psychotherapy may encompass psychologists and psychiatrists.

128. B. LANDIS, *supra* note 17, at 14.

129. *Id.*

130. Although the commercial significance of membership in the Institute when the rule existed is not certain, the Institute was praised for enforcing its rules and maintaining "a high degree of control within the membership." *Id.*

this article would mean that there was in fact no conduct restriction. Or the rule may have been designed to raise the quality of service offered in the market. If an association is attempting to certify that its members provide a higher quality of service than other professionals offer, it may establish stringent eligibility requirements and impose specific conduct restrictions that induce high quality behavior. However, it might also prescribe a price above the prevailing level and expect, indeed rely on the fact, that members will compete to raise the level of service provided. To induce additional services, a manufacturer may impose resale price maintenance rather than specify contractually the services that a retailer must render when retailers can more efficiently determine the exact services consumers value most highly. Analogously, an association might conclude that many elements of professional conduct which affect value are better determined individually than collectively. In the language of *Addyston Pipe*[131] and *BMI*,[132] such a price restriction would be ancillary to the integration of economic functions implicit in quality certification and therefore subject to a rule of reason.

In *National Society of Professional Engineers v. United States*[133] the Court considered a rule of an engineers' association that prohibited members from soliciting or submitting proposals on the basis of competitive bidding.[134] The association defined competitive bidding as the submission or receipt of estimates of cost or proposals "whereby the prospective client may compare engineering services on a price basis prior to the time that one engineer . . . has been selected for negotiations."[135] The case did not involve any claim that the National Society of Professional Engineers (hereinafter "Society") "tried to fix specific fees, or even a specific method of calculating fees."[136] Rather, the rule prevented members from discussing fees "until after a prospective client has selected the engineer for a particular project."[137] If negotiations with the chosen engineer were unsuccessful, the client was free to "withdraw his selection and approach a new engineer."[138]

131. United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899).
132. Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979).
133. 435 U.S. 679 (1978).
134. *Id.* at 683 n.3.
135. *Id.*
136. *Id.* at 682.
137. *Id.* at 682-83.
138. *Id.* at 684 n.6 (citing the district court's opinion at 389 F. Supp. 1193, 1215 (D.D.C. 1974)).

The kind of rule adopted by the Society does not constitute an agreement to charge specified prices or reduce output. It is not an agreement to rig bids — an allocation of bidding territories among competitors with the understanding that the bidder selected by the cartel will submit the low estimate and other participants will submit higher proposals. That kind of an agreement effectively creates a local monopoly for each member. Any of these practices would follow the cartel pricing explanation of anticompetitive effects.

Rather, the most plausible anticompetitive explanation for a rule like the Society's is that it increased consumer search costs. Members were free to set any prices they wished, but consumers were forced to negotiate with a single firm before they could discover another firm's price. The resulting sequential and laborious price search may have led consumers with high opportunity costs for their time to accept the first fee proposal, or at least an early bid. That would have led to a market structure that resembled monopolistic competition, with each firm charging a price determined by marginal revenue but earning no monopoly profits.[139] Alternatively, that kind of rule might be explained as a device to increase the incremental costs of supply. If submitting bids in competition with other bids is the most efficient way to increase output, a restriction on competitive bidding would increase the elasticity of supply in the industry. Price would be set at marginal cost, but marginal cost would be higher when demand is satisfied than it would otherwise be.[140]

The Court concluded, "On its face, this agreement restrains trade within the meaning of § 1 of the Sherman Act."[141] It went on to consider as an affirmative defense the Society's argument that "the restraint is justified because bidding on engineering services is inherently imprecise, would lead to deceptively low bids, and would thereby tempt individual engineers to do inferior work with consequent risk to public safety and health."[142] The Society also argued that competitive bidding would create "pressure to offer engineering services at the lowest possible price[, which] would adversely affect the quality of engineering."[143] The Court held that the defense was not cognizable under the Sherman Act and so could not save the practice under the rule of reason.[144] In essence, the court analyzed the Society's regulation under the rule of reason and held that the Society's defense was *per se* inadmissible.[145] The Court did not say

139. *See supra* notes 55-57 and accompanying text.
140. *See supra* notes 63-65 and accompanying text.
141. Professional Engineers, 435 U.S. at 693.
142. *Id.*
143. *Id.* at 685.
144. *Id.* at 696.
145. This interpretation is consistent with Professor Krattenmaker's explanation of the way in which the *per se* concept should be understood. *See* Krattenmaker, *supra* note

that the restriction could never be justified, but that the defense offered for it would automatically be rejected. At least in theory, the practice could be upheld if a different and legally adequate justification was offered.

The Court's treatment of the Society's proffered defense is unfortunate. There is no reason to believe that Congress intended to outlaw practices that increase consumer welfare, or for that matter, economic welfare.[146] Despite the Court's language, a better explanation for the decision might be that the Court did not clearly understand how the rule could increase welfare and therefore did not believe that it could. In fact, the Court probably had only a hazy view of the anticompetitive theory of the rule. The restriction undoubtedly looked more like restraints that had been condemned than agreements that had been blessed. An agreement among competitors that has a clear potential to inhibit rivalry is easy to outlaw when the efficiency-enhancing potential of it is mere smoke puffed from the cigars of the culprits. In other words, the harder it is to see something good in a practice, the worse the practice looks.

Although the Society's rule, on its face, comfortably fits one or two anticompetitive theories, it is far from clear that the rule had an anticompetitive effect. The Society accounted for slightly less than

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119. He points out that describing offenses as *per se* illegal is misleading:

> [W]e have confused offenses with defenses. What the Court means to say is that certain defenses or justifications frequently offered for price fixing (or group boycotts, or tying arrangements) are to be summarily rejected, without factual inquiry, either as a matter of principle or because experience teaches us that the costs of the inquiry will exceed any potential gains. No conduct is per se (that is, "by itself" or "intrinsically") a violation of the antitrust laws. However, certain defenses to such conduct are per se inadmissible or impermissible.

Id. at 172-73 (footnotes omitted).

146. This does not mean that the concept of a legally incognizable defense is inappropriate, only that it was largely misapplied here. If a group of firms argue that their pricefixing should be excused because they donate the monopoly profits from it to the United Way, their defense should be summarily rejected. The firms should not even be allowed to prove their assertions. Unlike a claim that an agreement on balance increases economic welfare in a single market, or even one that an agreement inescapably decreases economic welfare in one market but increases welfare in another by a greater amount, the asserted defense has nothing to do with the purpose of the antitrust laws, whether or not society would be better off because of the arrangement. Similarly, one could characterize Federal Trade Commission v. Superior Court Trial Lawyers Association, 110 S. Ct. 768 (1990), as a case in which the Court correctly *per se* rejected a defense. There, a group of criminal lawyers in private practice, who regularly accepted assignments to represent indigent defendants for fees set and paid by the District of Columbia, refused to accept new cases unless the fees were increased. *Id.* at 771-72. The Court summarily rejected the defense that the expressive purpose of the agreement to demand higher prices justified the conduct. *Id.* 778-82.

10 percent of all engineers in the country holding a college engineering degree.[147] It accounted for approximately 17 percent of all engineers licensed to practice by a state.[148] And it accounted for less than 7.5 percent of the consulting engineers in the country, those licensed engineers who offer their services directly to the public.[149] The Society may have had economic power in a market defined more narrowly than any of these figures suggest. But it appears that the Society had no market power by virtue of the number of its members, and no claim was made that competitive bidding was prohibited by law. If the Society had no market power, its rule could have had no anticompetitive effect.

The distinct possibility that the rule had no anticompetitive effect raises the question of whether there is an alternative explanation for the rule. The Society argued that it never enforced its ban,[150] but the district court found otherwise.[151] Still, as evidence of enforcement, the district court referred to "direct and indirect communication with members and prospective clients."[152] It cited "educational campaigns and personal admonitions to members and clients who were suspected of engaging in competitive bidding,"[153] but noted no instance in which a member was disciplined by expulsion or otherwise for engaging in the practice. That kind of "enforcement" is weak indeed; the rule may in fact have never restrained behavior, regardless of what the Society might have intended it to do.

However, assuming the rule was effective, and surely it was intended to do something, the explanation for it probably lies in the quality certification theory of professional rules. The Society groped for a quality-enhancing explanation in its argument before the Supreme Court, though it did not fully grasp the concept, and its reference to saving the public welfare was misleading.[154] Consumers were presumably free to solicit multiple simultaneous bids from non-member engineers, who were not bound by the rule. It is not clear whether a member had to withdraw his proposal if a bid was solic-

147. *See* United States v. Nat'l Soc'y of Professional Eng'r, 389 F. Supp. 1193, 1195 (D.D.C. 1974), *vacated*, 422 U.S. 1031 (1975), *aff'd in part & modified in part*, 555 F.2d 978 (1977), *aff'd*, 435 U.S. 679 (1978).

148. *Id.*

149. *See id.* at 1195 (approximately half of the 325,000 licensed engineers in the country, or 162,500, were consulting engineers); *Professional Engineers*, 435 U.S. at 682 (12,000 of the Society's members were consulting engineers).

150. *Professional Engineers*, 435 U.S. at 684 n.5.

151. *Professional Engineers*, 389 F. Supp. at 1200.

152. *Id.*

153. *Id.*

154. When a private rule is not adopted by law, and the association accounts for a small percentage of the profession, even a quality-enhancing rule can be ignored by nonmembers. A ban on competitive bidding conceivably could protect the public welfare given informational asymmetries, but not if it applies only to a small proportion of the suppliers in the market.

ited from a non-member, as opposed to a member, but in any event, only one member's proposal could be considered by a potential client at any one time. If the Society had developed a reputation for quality, clients might have found non-members a poor substitute. But then to force Society members to compete with each other, and thereby to lower the price and quality of the services they offered because of the consumer's informational disadvantage, would have destroyed the value of the certification and forced consumers to incur higher search costs to find the quality of professional they desired, assuming services of that quality would continue to have been offered in the market. Surely the antitrust laws were not designed to work that result.

The Supreme Court alluded to the figures suggesting that the Society lacked market power, but it did not seem to digest their significance. Perhaps if the Court had considered the improbability of an anticompetitive effect flowing from a rule of an association representing such a small share of the profession, it would have listened more carefully to the Society's defense. At least it might have been less hostile to the argument, even if it had reached the same result.

Suppose that the Society adopted the competitive bidding rule along with its other ethical mandates when it accounted for 10 percent of the narrowest properly defined antitrust market, and that it grew to encompass 90 percent. The rule would then represent an agreement among firms with market power. This raises the question of whether the rule then reduces welfare. Conduct restrictions can increase quality and enhance welfare whether or not maintained by firms with market power.[155] When an association without market power imposes conduct restrictions and grows to possess that power, the question is: Did the association grow *because* of the restriction and others like it, or did it grow for unrelated reasons? The answer to that question will often be unclear. But when no alternative and persuasive reason for the association's growth is evident, the most plausible inference is that market power is the product of demand-increasing restrictions. Condemning the restrictions would reduce welfare.

Advertising restraints are particularly susceptible to summary condemnation on the ground that an anticompetitive explanation exists for them and they have been empirically proven to reduce welfare in a professional services market. As discussed earlier, an adver-

155. *See supra* notes 88-116 and accompanying text.

tising restriction has been used as a prime example of a device that increases consumer search costs and the incremental costs of supply. Moreover, it is one of the rare restraints that has been studied empirically in a professional setting.

Studies of optometric product and service markets concluded that advertising restrictions increased prices,[156] and increased prices without increasing quality.[157] In particular, the Bureau of Economics of the Federal Trade Commission conducted an experiment to assess the effects on price and quality of advertising restraints.[158] Nineteen subjects with "relatively routine visual problems"[159] were sent to various cities to obtain eye examinations and eyeglasses from optometrists. In some cities, some optometrists advertised, and these cities were labelled, "nonrestrictive"; in other cities, virtually no advertising was observed, and they were labelled, "restrictive."[160] The quality of the services received was then evaluated along four dimensions: "(1) thoroughness of the eye examination; (2) accuracy of the prescription; (3) accuracy and workmanship of the resulting eyeglasses; and (4) extent of unnecessary prescribing."[161]

Manifestly, the dimensions of quality used were limited and did not permit a direct evaluation of other important elements of service. For example, the methodology did not permit a direct assessment of whether subjects with unusual visual problems would have received the same diagnoses from advertising and non-advertising optometrists. Moreover, the quality dimensions studied were necessarily objective measures. If consumers placed any subjective valuation on receiving services from an optometrist who did not advertise, and they may well not have, this study could not have reflected that value. The concept of quality used in this Article embraces any such subjective value.

Nevertheless, the study concluded that on three of four dimensions — accuracy of prescription, quality of eyeglasses, and unnecessary prescriptions — advertising optometrists performed no worse than non-advertising practitioners.[162] The examinations given by advertising optometrists were less thorough than those given by non-advertis-

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156. *See* Benham, *The Effect of Advertising on the Price of Eyeglasses*, 15 J. L. & ECON. 337 (1972).

157. *See* R. Bond, J. Kwoka, Jr., J. Phelan & I. Whitten, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry [hereinafter FTC Report]; Kwoka, *Advertising and the Price and Quality of Optometric Services*, 74 AM. ECON. REV. 211 (1984). The Kwoka paper is based on the data collected in the FTC Report. *See id.* at 212. Therefore, any methodological problems inherent in the FTC Report would carry over to the Kwoka study.

158. *See* FTC Report, *supra* note 157.

159. *Id.* at 7.

160. *See id.* at 2.

161. *Id.* at 6.

162. See *id.* at 14, 20.

ers in the same geographic market.[163] However, the percentage of optometrists who gave deficient examinations was about the same in restrictive and nonrestrictive cities.[164] Prices for the same services were higher in restrictive cities than in nonrestrictive cities.[165] In nonrestrictive cities, nonadvertising optometrists gave more thorough examinations and charged higher prices than advertising optometrists.[166]

The FTC Report did not attempt to explain why advertising failed to occur in the nonrestrictive cities.[167] It merely commented generally that advertising restrictions "are imposed by licensing boards, state law, or private professional organizations through canons of ethics."[168] However, the national association for the profession severely limited advertising.[169] Given that advertising did occur in some cities, the source of the advertising restraints in restrictive cities presumably was the government. Indeed, the advertisers in nonrestrictive cities presumably did not belong to the association. If the nonadvertisers in those cities did belong to the association and provided more thorough examinations at a higher price, the certification function may have been operating well.

Therefore, these studies may stand for the proposition that advertising restraints imposed by law on optometrists reduce welfare.[170] However, they provide little or no support for condemning *per se* all association rules that limit advertising.[171] Though some other profes-

163. *See id.* at 13-14.
164. *See id.* at 13.
165. *See id.* at 25.
166. *See id.*
167. The problems posed by the methodology used in the FTC Report to classify geographic markets as restrictive or nonrestrictive are discussed in Haas-Wilson, *The Effect of Commercial Practice Restrictions: The Case of Optometry*, 29 J. L. & ECON. 165, 166-68 (1986).
168. FTC Report, *supra* note 157, at Executive Summary 1.
169. *See* E. HEERMANCE, *supra* note 18, at 398-99; J. CLAPP, *supra* note 18, at 515.
170. The FTC Report was preceded by a trade regulation rule the FTC promulgated in 1978. The Trade Regulation Rule on the Advertising of Ophthalmic Goods and Services, or "Eyeglasses I", codified at 16 C.F.R. § 456, prohibited bans on nondeceptive advertising and required vision care providers to furnish copies of prescriptions to consumers after eye exams. The circuit court upheld the prescription release requirement but remanded the advertising part of the regulation for reconsideration in light of Bates v. State Bar of Arizona, 433 U.S. 350 (1977). American Optometric Ass'n v. FTC, 626 F.2d 896 (D.C. Cir. 1980).
171. The strongest argument that advertising restrictions reduce economic welfare pertains to government-imposed restraints, but these restraints will often be protected from antitrust scrutiny by the state action doctrine. *See* Parker v. Brown, 317 U.S. 341 (1943). That doctrine protects any advertising prohibition imposed by a legislature (*see*

sions undoubtedly are indistinguishable from optometry in relevant economic respects, some surely are distinguishable. In particular, the magnitude of the informational asymmetry and the idiosyncratic value consumers place on advertising may vary across professions. Moreover, the studies do not purport to show that welfare suffers when an association imposes advertising restrictions that are not adopted by the state (or perhaps when the association otherwise lacks economic power). Indeed, the studies imply that associations with no market power sometimes adopt private restraints; there is also a considerable amount of suggestive evidence to the same effect. A host of professional associations, from the American Association of Marriage and Family Counselors[172] to the American Physical Therapy Association,[173] have restricted advertising.[174] Advertising

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Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48 (1984)) or, in the case of attorneys, by a state supreme court (*see* Bates v. State Bar of Arizona, 433 U.S. 350 (1977)). If imposed by a state regulatory agency, the ban would be protected if it is consistent with a clearly articulated and affirmatively expressed legislative policy and the policy is actively supervised by the agency. *See* California Retail Liquor Dealers Ass'n v. Midcal Aluminum, 445 U.S. 97 (1980). In particular, an advertising restraint adopted by a regulatory agency with an inadequate legislative mandate would not be protected. For a discussion of the clear legislative policy requirement, see Lopatka, *The State of "State Action" Antitrust Immunity: A Progress Report*, 46 LA. L. REV. 941, 995-1002 (1986).

However, state laws prohibiting advertising are no longer a major concern. In Virginia State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 770 (1976), the Court held that a state could not ban price advertising by pharmacists consistent with the first amendment though it could regulate it in other ways. In *Bates*, the Court extended the constitutional holding of *Virginia Pharmacy* to advertising by attorneys. *Bates*, 433 U.S. at 384. Ironically, then, the most serious potential instances of anticompetitive harm flowing from advertising restraints are off-limits to antitrust enforcement, but they are nevertheless infirm under the constitution. Antitrust enforcement is confined to restraints that are not likely to offend antitrust principles.

172. *See* J. CLAPP, *supra* note 18, at 431.

173. *See id.* at 562.

174. Other associations that adopted stringent restrictions on advertising include the following: American Dental Association, reported in E. HEERMANCE, *supra* note 18, at 143, J. CLAPP, *supra* note 18, at 228; American Bar Association, E. HEERMANCE, *supra* note 18, at 286; American Veterinary Medical Association, *id.* at 519; American Institute of Accountants, *id.* at 6; American Arbitration Association, J. CLAPP, *supra* note 18, at 80; National Society of Professional Engineers, *id.* at 253; International Bar Association, *id.* at 414; American Pharmaceutical Association, *id.* at 550; American Speech and Hearing Association, *id.* at 743.

Some associations adopted rules that prohibit undignified or self-laudatory advertising, and those rules could have been enforced more or less strictly; *e.g.*, the codes of the following associations: American Society of Heating and Ventilating Engineers, American Society of Mechanical Engineers, and Society of Naval Architects and Marine Engineers, reported in E. HEERMANCE, *supra* note 18, at 163; American Institute of Consulting Engineers, *id.* at 166; Photographers' Association of America, *id.* at 431; National Funeral Directors Association of the United States, *id.* at 516; Society of Actuaries, J. CLAPP, *supra* note 18, at 26; Engineers' Council for Professional Development, *id.* at 248; American Society of Landscape Architects, *id.* at 399; American Congress on Surveying and Mapping, *id.* at 748.

Some associations prohibit false or misleading advertising. If enforced according to its terms, of course, such a restriction would not even arguably serve an anticompetitive restraints appear to be a common feature of British professional associations.[175] It is simply inconceivable that all of the associations that have restrained advertising had market power, whether derived from state law or unrelated economic sources.

An association might adopt a restraint hoping that someday it will have market power, that the restraint will then increase rents anticompetitively, and that the restraint will have no adverse impact on its members in the meantime. But the adoption of the rule by several of these associations suggest that the restraint has a different purpose and, more importantly, a different effect. For example, the American Osteopathic Association banned advertising,[176] and the members of that association presumably competed with and constituted a much smaller share of the market than physicians. Just as a member of an association that imposes an anticompetitive restraint has an incentive to cheat, non-members can profit by engaging in the restrained practice. Osteopaths as a group presumably stood to gain by advertising when physicians were not[177] if the advertising merely increased the incremental costs of supply. Of course in the long run, all suppliers will benefit if they all adhere to the restriction, but this is merely to recognize that competition can impose negative externalities on rivals. Cheating on any cartel will ultimately harm the economic interests of the cheater, but that does not stop chiseling. Even if state law prohibited osteopaths from advertising, the society would not be expected to endorse the prohibition.[178]

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purpose and would potentially serve a welfare-enhancing one. *See, e.g.*, the codes of the following: National Hairdressers Association, E. HEERMANCE, *supra* note 18, at 221; Board for Certification of Genealogists, J. CLAPP, *supra* note 18, at 322; Guild of Prescription Opticians of America, *id.* at 507.

175. *See, e.g.*, A CARR-SAUNDERS & P. WILSON, THE PROFESSIONS 517-18, 522, 526 (1933) (The Warning Notice of the General Medical Council and the report of enforcement activities of the Council, and the Code of Professional Practice of the R.I.B.A).

176. *See* E. HEERMANCE, *supra* note 18, at 350.

177. The American Medical Association long restricted advertising. *See* B. LANDIS, *supra* note 17, at 41, 46; C. TAEUSCH, *supra* note 11, at 186-89; E. HEERMANCE, *supra* note 18, at 339.

178. Similar questions are raised by the advertising restrictions adopted by the American Podiatry Association whose members compete with orthopedists *see* J. CLAPP, *supra* note 18, at 593; the American Psychological Association whose members compete with psychiatrists, *id.* at 630; the American Chiropractic Association, whose members compete with physicians, *id.* at 160; and even the American Optometric Association whose members compete with ophthalmologists, *see* E. HEERMANCE, *supra* note 18, at 398-400. The services of each professional in an identified pair certainly are not perfect substitutes, and whether they should be included in the same market is by no means clear. Moreover, which of the two professions is dominant even if they are in the same market is not clear. Yet, inter-profession competition exists to some degree, and the an-

Further, though an advertising ban can have an anticompetitive effect, advertising inherently tends to increase public awareness of a service and to stimulate demand. That effect may be insignificant with respect to some professional services, but not others. If a profession is little known, it would most likely have more to gain by increasing demand through advertising than by working an anticompetitive result through an advertising restriction. If that kind of association imposes a ban, the strongest inference is that the restriction serves some demand-increasing function that overshadows the tendency of advertising to stimulate demand by informing the public of available services.[179] For example, the Society For Clinical and Experimental Hypnosis, Inc., severely restrained advertising,[180] even though consumers probably have only a passing awareness of the availability and uses of hypnosis.[181] If such an association loses profits by not advertising, even when it has market power in a small market, it could not impose the restraint without costs while it waited to acquire market power. In other words, associations with no market power are more likely to acquire it by advertising than by not advertising.[182]

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ticompetitive theories for advertising restraints do not persuasively explain why the members of both competing professions would restrict themselves.

179. The 1970 Standards of Professional Advertising Practice of the Society of Real Estate Appraisers suggest this dynamic. *See* J. CLAPP, *supra* note 18, at 72. They provide:

> The appraisal profession is young and the general public is not fully aware of the importance of the role of the professional appraiser. . . . [U]ntil this public awareness and recognition comes into being, the Society realizes that in many instances it is essential for its members to advertise their professional attainment and services within certain limitation. The Society has therefore established . . . standards of professional advertising practices. . . .

Id.

The Society proceeded to adopt extensive advertising restraints. *See id.* at 72-76.

180. *See id.* at 365.

181. The obvious demand-enhancing potential of an advertising ban in the case of the hypnotists is a recognition that consumers would view advertising hypnotists as quacks and charlatans. A similar concern might underlie the advertising restriction imposed by the American Chiropractic Association. *See id.* at 160-61.

182. Limited empirical analysis has been conducted on some restrictions besides an advertising restraint. The FTC study purported to include restrictions on the employment of optometrists by nonprofessional corporations, the permissible location of optometrists' offices, the operation of multiple offices, and the use of trade names by optometrists employed by nonprofessional corporations. *See* FTC Report, *supra* note 157, at Executive Summary 1. That Report formed part of the foundation for a second trade regulation rule promulgated by the FTC in the area of ophthalmic services. The "Eyeglasses II" Rule prohibited states and local governmental entities from imposing various restrictions on commercial practices by suppliers of these services. *See* Trade Regulation Rules; Opthalmic Practice Rules, 54 Fed. Reg. 10,285 (1989) (to be codified at 16 C.F.R. § 456). The Commission's rule was vacated by the circuit court on the ground that, under state action principles, the rule impermissibly applied to state policies. *See* California State Bd. of Optometry v. FTC, 910 F.2d 976 (D.C. Cir. 1990). A similar study of so-called commercial practice restrictions was reported in Benham & Benham, *Regulating through the Professions: A Perspective on Information Control*, 18 J. L. & ECON. 421,

Application of a *per se* rule to professional rules, at least to the great bulk of them, is not supported — not by theory, not by suggestive evidence, not by empirical analysis. Although this may change, antitrust doctrine is tethered to human knowledge. The traditional alternative to the *per se* rule is the rule of reason, which requires proof that the net effect of the subject restraint is a reduction in economic welfare.[183] Many lower courts have held that the first step of rule of reason analysis is proof that the defendant or defendants possessed market power,[184] and that requires definition of a relevant product and geographic market.

2. *Mass. Board review*

Principally to avoid the burden of proving market power, the Federal Trade Commission in recent years has used an analysis somewhere between the *per se* rule and its conception of the rule of reason.[185] Called the "Mass. Board" approach after the name of the case in which the FTC first articulated the analysis, it asks a series of three questions: "First, we ask whether the restraint is 'inherently suspect.' In other words, is the practice the kind that appears likely,

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424-25 (1975). The methodology used in both studies obscures the source of the restrictions and therefore makes them of little use in forming an appropriate antitrust rule. *See* Haas-Wilson, *supra* note 167, at 166-68. Haas-Wilson attempted to cure the methodological problem by explicitly studying the effects of commercial practice restrictions imposed by state law on optometrists, using the FTC data. *See id.* at 168, 168 n.13. Her study, therefore, was not intended to and does not support application of a *per se* rule to commercial practice restrictions adopted exclusively by a private association. Further, all three studies pertain solely to optometry.

Some other professional services markets have also been the subjects of empirical study. *See, e.g.*, Schroeter, Smith & Cox, *Advertising and Competition in Routine Legal Service Markets: An Empirical Investigation*, 36 J. INDUS. ECON. 49 (1987).

183. *See, e.g.*, Nat'l Collegiate Athletic Ass'n v. Univ. of Okla., 468 U.S. 85 (1984) (Under either the per se rule or the rule of reason, the essential inquiry is the same — whether the challenged restraint enhances competition).

184. *See, e.g.*, Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 221 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987); Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., 784 F.2d 1325, 1334 (7th Cir. 1986); Polk Bros., Inc. v. Forest City Enter., Inc., 776 F.2d 185, 191 (7th Cir. 1985); Brunswick Corp. v. Riegel Textile Corp., 752 F.2d 261, 265 (7th Cir. 1984), *cert. denied*, 492 U.S. 1018 (1985); General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d 588, 596 (7th Cir. 1984); White & White, Inc. v. American Hosp. Supply Corp., 723 F.2d 495, 500-04 (6th Cir. 1983); Graphic Prods. Distribs., Inc. v. Itek Corp., 717 F.2d 1560, 1568-72 (11th Cir. 1983); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 298 (5th Cir. 1981); Cowley v. Braden Indus., Inc., 613 F.2d 751, 755 (9th Cir. 1980), *cert. denied*, 446 U.S. 965 (1980).

185. *See In re* Massachusetts Bd. of Registration in Optometry, 110 F.T.C. 549 (1988).

absent an efficiency justification, 'to restrict competition and decrease output'?" If not, "the traditional rule of reason, with attendant issues of market definition and power, must be employed." If the restraint is inherently suspect, the second question is asked: "Is there a plausible efficiency justification for the practice?" If no such justification exists, the restraint is condemned. Otherwise, the analysis proceeds to the third question: Is the justification "really valid"? If so, the restraint is analyzed under the rule of reason; if not, it is condemned without further inquiry.[186]

The Mass. Board approach is like an eclair without custard — it looks good, even tastes good, but something is missing. First of all, no one has yet been able to describe with anything approaching precision what "inherently suspect" means. Some who apply the analysis define it expansively to refer to an agreement that restricts a significant element of rivalry among competitors. Others interpret it more narrowly to refer to a practice for which there exists a persuasive theory of an anticompetitive outcome, supported by some credible evidence.[187] The inherent fuzziness of the term invites inordinate effort simply to determine whether the analysis is triggered. But that is not the major shortcoming of the Mass. Board approach.

The inherently suspect category of restraints could be read to be coextensive with the *per se* illegal category. In that case, only a few practices would survive the first step, and as to those, potential defenses which would not be considered at all under traditional *per se* analysis, would be recognized. That might be good policy, even if it would also be inconsistent with some Supreme Court precedents.[188] But that is clearly not what the FTC had in mind. Rather, the analysis was intended to apply to a broader universe of conduct, though just how broad is debatable. The implication of the analysis is that competitively ambiguous conduct is called into question, and the de-

186. *Id.* at 604.

187. *See* Langenfeld & Morris, *Analyzing Agreements*, *supra* note 16; Langenfeld, Antitrust Enforcement: The Gray Area of Agreements Among Competitors 13-21, presented at the CATO Institute Conference, Washington, D.C., April 11, 1990.

188. In Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982), the Court explained that a *per se* rule is expected to condemn a practice in some instances in which it has a procompetitive effect: "As in every rule of general application, the match between the presumed and actual is imperfect. For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that fullblown inquiry might have proved to be reasonable." *Id.* at 344. The Court cited, *inter alia*, United States v. Topco Assocs., 405 U.S. 596, 609 (1972), a case in which a horizontal territorial division among grocery stores, which had no market power, undertaken for a plainly procompetitive purpose, was nevertheless condemned *per se*. *Arizona v. Maricopa County Medical Soc'y* at 344 n.16. The Court, therefore, was recognizing that the *per se* rule will condemn certain practices even when a procompetitive justification is compelling. To that extent, the rationale is flatly inconsistent with Mass. Board analysis, which is intended to permit every actual instance of a practice that produces procompetitive effects.

fendants are forced to justify it. Further, the defendants must affirmatively justify it, not merely prove that they have no market power and rely upon the inference that the conduct therefore cannot have an anticompetitive effect. The FTC believed that the chief virtue of the Mass. Board approach was that it allowed inherently suspect practices to be condemned without any inquiry into market power. For that reason, none of the first three steps of the analysis — identification of inherently suspect conduct, of a procompetitive theory, and of supporting evidence — can be read to allow the submission of evidence regarding and consideration of market power.[189]

If defendants could always and easily articulate and support a procompetitive rationale for conduct that was not anticompetitive, the analysis would be harmless. Of course, competitively neutral conduct would be condemned because, by definition, such conduct has no procompetitive justification. However, the associated economic welfare loss, would be relatively small. Although enforcement resources would be consumed needlessly, the underlying conduct outlawed would not have increased welfare any activities will survive the analysis because the efficiency-enhancing theory will be obvious and the effect self-evident.[190]

The approach poses a more subtle danger. Defendants will usually be able to describe what they do, and they may be able to explain generally why they do it, but they will often be unable to identify all of the effects it has or to articulate why it has those effects. Defendants may know that arbitrating disputes is good business, but they may not be able to describe in economic terms why that is so. In the end, the insidious effect of the Mass. Board approach is to stifle the opportunity for firms to experiment with business practices. And the harm emanating from implicit or explicit legal impediments to effi-

189. To the extent that Mass. Board precludes an inquiry into market power with respect to conduct that does not fit a traditional *per se* category, the analysis is the mirror image of that adopted by those lower courts that require a showing of market power regarding conduct that is not *per se* illegal. *See supra* note 184 and the accompanying text.

190. The Mass. Board approach can be understood to mean that a practice is not justified by a plausible efficiency unless it is the least restrictive means of achieving the efficiency. *See* Langenfeld & Morris, *Analyzing Agreements*, *supra* note 16, at 30. The "less restrictive alternative" inquiry is fine in theory and often useless in practice. A practice that is less restrictive of competition than another may also be a less efficient means of reaching a desired result. It is only preferable to the one chosen if it would have a net positive impact on welfare relative to the first. But that conclusion will rarely be demonstrable. If the association is not apt to be able to offer a clear explanation for the rule it adopted, it will hardly be able to explain why some other rule would have been less successful. *See generally* Easterbrook, *supra* note 5, at 8-9.

cient practices, because legal barriers are relatively permanent, will usually exceed the damage caused by inefficient private conduct, because the market tends to be self-correcting over time.[191]

The danger to economic creativity, or the loss of efficiency-enhancing activities that are deterred by using the Mass. Board approach, could be justified by some countervailing benefit. If opening the inquiry to encompass market power was sufficiently costly, the case would be made. The costs of the inquiry are usually considered to be the resources expended in assessing market power and the costs of erroneous determinations of legal validity. The litigation costs depend upon the way in which market power is incorporated into the analysis. Costs incurred voluntarily are largely an irrelevant policy concern. Thus, if defendants were allowed to assert the absence of market power as a defense, the costs the defendants would incur are unimportant. They would choose to incur those costs only if the market power defense was less expensive to establish than a procompetitive justification. Therefore, permitting the defense could only lower the defendants' litigation costs.

Rather, any concern would relate the plaintiff's costs incurred in refuting the defense and the tribunal's costs in resolving the dispute. If the burden of persuasion is on the defendant, and the claim is specious, the external costs imposed by the defendant's assertion on the other economic actors involved will be insignificant. The plaintiff will not have to respond, and the tribunal will be able to conclude simply that the defendants' burden was not met. The external costs will be significant only if the defense is serious, only if the defendants' have submitted enough evidence of a lack of market power that they would win summary judgment. In that case, the risk that failure to examine market power will result in condemnation of beneficial conduct will be substantial.[192]

An inquiry into market power could only increase the risk that deleterious practices will escape condemnation to the extent that defendants may have market power but the plaintiff is unable to disprove it. An accurate determination that defendants lack market power cannot possibly lead to an erroneous acquittal. Market power analysis may be expensive, and it will not always be correctly resolved, but it will certainly be resolved correctly more often than not.

191. *See generally* Easterbrook, *supra* note 5, at 5-7.

192. If the plaintiff were required to prove the possession of market power as an element of its case, the involuntary costs would be greater. The plaintiff would have to incur the associated litigation costs even when the defendant has market power, regardless of the amount of expense. Of course, the magnitude of those costs will depend upon the context of the inquiry and the standard to which the plaintiff is held. The less clear it is that the defendants have market power, the more expensive the showing will be. However, the costs may still be justified if the requirement sufficiently reduces legal errors of overinclusion and the associated effects on the economy.

If this were not true, the country's merger policy would be a long-standing and cruel joke. Merger analysis begins with and turns upon market power analysis, and its results are deemed sufficiently reliable to shape the structure of the economy. Therefore, on balance, a market power inquiry would necessarily reduce the costs of legal error.

Thus, if market power analysis is to be precluded, the reason must be that the resources consumed in making the inquiry are great, the reduction in legal errors the inquiry brings about is small, and the loss to the economy associated with overdeterrence is insubstantial. However, these conclusions are not substantiated. The resource commitment will not always or even usually be large, the reduction in legal errors may be pronounced, and the economic burden of overdeterrence is heavy.

3. *Flexible rule of reason*

Rejection of the *per se* rule and the Mass. Board approach calls for consideration of some alternative principle for judging association rules. The likely candidate is the rule of reason. However, application of that rule does not necessarily require the rigid analysis that the FTC and some lower courts have attributed to it. Rather, what is emerging today is a "flexible rule of reason." Essentially, as it is applied in practice, the rule of reason is a function of three variables: the strength of the anticompetitive story, the strength of any procompetitive story, and the presence or absence of market power. Market power could be imported into either or both of the first two elements, but it is more convenient to treat it separately. The strength of the story refers to the persuasiveness of the identified theory and the weight of the supporting evidence. This means that a theory predicting how a practice of the type involved could produce a particular effect must be articulated clearly and evidence must be adduced that bears upon the effect of the practice in the context in which it is challenged. To the extent that a practice has been proven empirically to produce certain effects in some market, the theory that the practice will have analogous effects in the relevant market becomes more powerful, but it still must be supported by the weight of the evidence. For example, a plausible anticompetitive theory, for which there is a little supporting evidence and a little contradictory evidence, tells a weak story.

Conduct cannot properly be condemned under the rule of reason unless there is, at a minimum, an articulate anticompetitive story.

That principle is simply a recognition that the antitrust laws condemn anticompetitive practices, rather than practices that are not procompetitive. This means that the plaintiff bears the ultimate burden of persuasion. The strength of the story necessary to satisfy that burden depends upon the strength of any competing procompetitive story and evidence that bears upon market power. If the anticompetitive story is strong, and the procompetitive story is weak, the practice can be condemned without an elaborate showing of market power. That does not mean that market power is irrelevant, only that the significance of market power varies with the strength of the competing stories, or more precisely, with the positive amount by which the strength of the anticompetitive story exceeds that of the procompetitive one.

Thus, the oath of office for an antitrust judge does not include a solemn promise to disregard common sense. A judge can take notice of the fact that the geographic scope of dental services markets tends to be local, that the only suppliers in the product market are likely to be licensed dentists, and that if all of the dentists in a community agree to a restraint, they are likely to have market power.[193] That kind of evidence, coupled with a strong anticompetitive story and a weak procompetitive one, should be enough for the plaintiff to satisfy its burden of persuasion. Conversely, a strong anticompetitive story should be defeated by conclusive proof of the absence of market power regardless of the weakness of the procompetitive story. Such a principle is necessary to protect experimentation in the economy and to allow defendants to select the cheapest way to respond to antitrust complaints. In all, the weaker the anticompetitive story is, the

193. For example, in FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986), dentists in three communities agreed not to submit x-rays to insurance companies in conjunction with claim forms. The Supreme Court held that the record adequately supported an order of the FTC finding an antitrust violation. *Id.* at 466. On the one hand, the agreement arguably raised the costs incurred by insurance companies in verifying that the dental services performed were necessary and therefore covered by the patients' policies, and this, in turn, could have raised the price of premiums by increasing either the amount of reimbursement paid out or the costs of determining coverage. There was evidence that insurance companies actually had been unable to obtain compliance with their requests for x-rays in two of the affected communities over a period of years and that they had experienced little difficulty in other areas. *Id.* at 457. On the other hand, the Court observed, "No credible argument has been advanced for the proposition that making it more costly for the insurers and patients who are dentists' customers to obtain information needed for evaluating the dentists' diagnoses has any such procompetitive effect." *Id.* at 459. Thus, to the Court, there was a strong anticompetitive story and a weak procompetitive one. Moreover, the Court recited the FTC's finding that participating dentists "constituted heavy majorities of the practicing dentists" in two localities — nearly 100 percent of the dental specialists in one community and approximate 67 percent of the dentists in another. *Id.* at 451, 460. Therefore, there was evidence of market power. The Court noted that the FTC's decision found support "in common sense and economic theory, upon both of which the FTC may reasonably rely. . . ." *Id.* at 456. No doubt, federal courts have similar latitude to rely on common sense and economic theory.

weaker the procompetitive story or the showing of lack of market power need be to defeat the complaint.

When the anticompetitive and procompetitive stories are both strong, but market power is obviously absent, the defendants should win. Problems arise when the competing stories are equally strong and a quick look at market power is inconclusive. That case requires an elaborate inquiry into market power and, unless that inquiry permits a conclusive finding that market power is absent, an attempt to quantify procompetitive and anticompetitive effects. That case requires the classic evaluation of reasonableness because there is no alternative. But many cases, perhaps most, can be resolved without reaching that point.

This analysis is not consistent with all Supreme Court precedent. The antitrust principle that is consistent with all of the Court's opinions has yet to be identified. However, it is consistent with many cases. Certainly the Court's explicit and implicit exposition of the elements of the analysis as they relate to individual cases can be criticized, but for the most part, the elements themselves can be found in the Court's recent opinions, and they are often implicitly used in the ways suggested.[194]

B. *Analytical Guidelines*

This analysis cannot and is not intended to demonstrate that particular kinds of professional rules are always either procompetitive or anticompetitive. To the contrary, it implies that any given rule has to be evaluated in the context in which it is challenged. Although the concept of the flexible rule of reason is generally applicable, the foregoing analysis of professional rules suggests various specific inquiries that are subsumed in the elements of the basic approach. These in-

194. For example, in National Collegiate Athletic Ass'n v. University of Okla., 468 U.S. 85 (1984), the Court perceived a strong anticompetitive theory with respect to an agreement to restrict the number of college football games televised, coupled with proof of anticompetitive effects — fewer games were televised and the prices paid by advertisers for promotional time were higher. The Court found that the proffered efficiency justifications were relatively insubstantial. And it noted, "As a factual matter, it is evident that petitioner does possess market power." *Id.* at 111. *See also* FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986), discussed at *supra* note 193. The most notable exception to this analysis is United States v. Nat'l Soc'y of Professional Eng'r, 389 F. Supp. 1193, (D.D.C. 1974), *vacated*, 422 U.S. 1031 (1975), *aff'd in part & modified in part*, 555 F.2d 978 (1977), *aff'd*, 435 U.S. 679 (1978). *See also* note 147 and accompanying text. *In Professional Engineers*, the Court identified a strong anticompetitive theory and some supporting evidence, but saw no cognizable procompetitive theory. It apparently ignored substantial evidence of a lack of market power.

quiries suggest certain guidelines that are useful in assessing the strength of the anticompetitive story, the strength of the procompetitive story, and the existence or non-existence of market power.

1. PROFESSIONAL RULES ARE RESTRAINTS ONLY IF AND AS ENFORCED. If rules are to *restrain* behavior, they must prevent those restrained from doing something that they would otherwise do. Suppliers could agree to fix prices without creating an enforcement mechanism, hoping that all recognize the disastrous effects of cheating and exercise self-discipline, but even such a rare agreement is likely to be so short-lived as to warrant little expenditure of enforcement resources. Unenforced "restraints" can be ignored. Restraints that are enforced may bear close or little resemblance to the written rule. A rule may be interpreted more or less restrictively. The antitrust significance of a rule depends upon how it is understood by those subject to it and that, in turn, depends upon how it is enforced.

2. PRIVATE ASSOCIATION RULES THAT ARE NOT ALSO EMBODIED IN LAW ARE LESS LIKELY TO INJURE WELFARE THAN THOSE THAT ARE. An association cannot enforce its purely private rules unless membership is economically important. If membership is important, there is a danger that it is so *because* of the rules. If an association has power to affect price solely because its members offers more highly valued services than do other professionals, the rules cannot be condemned by an antitrust court without reducing welfare. A rule can be unrelated to any productive economic activity and cause an anticompetitive effect, but it will often be difficult in practice to determine that the rule is unrelated to the source of the association's economic power. Moreover, economic rents may be necessary to compensate the association for risk inherent in establishing itself in the market, and therefore to stimulate such ventures in the future. And the anticompetitive effect of private rules that generate unnecessary monopoly rents is susceptible to erosion, as competition from non-members and members of rival associations grows. The costs of erroneously condemning a rule are likely to be much higher than the costs of erroneously permitting one. Consequently, unless the rule clearly serves no efficiency-enhancing function, it should be permitted.

The ability to enforce an anticompetitive restraint is much more likely to emanate from the power of the state than from the economic power of the association. Though government adoption of a rule is not determinative of anticompetitive effect or intent, it is very nearly a necessary condition of significant economic harm. Suppose the Czar of Economic Matters had to choose between two states: a society devoid of government regulation, with an attendant adverse impact on the maintenance of value-enhancing property rights and the elimination of informational asymmetries on the one hand; and one ordered by statutory and administrative restrictions that might or might not increase welfare on the other. The Czar would do well to choose the former. The expected costs of error are lower. Of course, a professional rule that is consonant with a legal mandate, though it may therefore have the power to reduce welfare, is likely to be protected from antitrust attack by the state action doctrine.

3. PURELY PRIVATE RULES OF AN ASSOCIATION THAT ATTEMPT TO LIMIT MEMBERSHIP TO A SMALL PART OF THE PROFESSION ARE NOT LIKELY TO BE ANTICOMPETITIVE. If an association is relying upon unrelated economic power to enforce an anticompetitive rule, it will have to suppress competition. Its incentive will be to extend its influence to as large a proportion of the actual and potential suppliers in a market as it can. Though a market may be smaller than a profession, individuals in the same profession that are outside of the market are the most likely entrants. Thus, the anticompetitive association that is not supported by government action will generally try to force as large a percentage of a profession to join the association as it can.

4. A PURELY PRIVATE RULE THAT IS ADOPTED WHEN AN ASSOCIATION ACCOUNTS FOR A SMALL PART OF A PROFESSION IS UNLIKELY TO BE ANTICOMPETITIVE EVEN IF THE ASSOCIATION HAS GROWN TO ENCOMPASS A LARGE PART OF THE PROFESSION BY THE TIME THE RULE IS CHALLENGED. There is an inference, though not an inescapable one, that if a rule is adopted when an association has no market power, and the association thereafter grows to possess market power, the rule increases welfare. In other words, any economic power the association has is not likely to be independent of the rule. The rule could not have been anticompetitive when adopted, and so unless the rule initially had no effect, it must have increased welfare in the beginning. A single rule can have a procompetitive effect at one time and a different effect as the market structure evolves, but that is not likely. An association could deliberately adopt a rule that is intended to lie dormant until market conditions permit it to have an anticompetitive effect, but that ascribes to an ordinary group of professionals a degree of perspicacity that is difficult to believe. More likely, an association could adopt a rule simply because it observes that another association in the same or a different profession has the rule. The similarity of rules across professions suggests some amount of sheer mimicry. In that event, a welfare-enhancing explanation for the rule based on the rule's presumed initial effect, though it is not precluded by the rule's undeliberate origin, is less compelling. Still,

the most persuasive explanation for a rule that is adopted when an association is small is that it was and remains procompetitive.

5. THE INTENT OF AN ASSOCIATION IN ADOPTING A RULE, TO THE EXTENT IT CAN BE DISCERNED, CAN BE SUGGESTIVE BUT IS NOT LIKELY TO BE DETERMINATIVE OF THE RULE'S EFFECT. Intent evidence will often be unavailable. When it is, it has to be used very carefully. Evidence that a rule was designed to address some problem in the market, such as fraudulent practices, however unartfully the explanation is articulated, suggests that the rule has a welfare-enhancing effect. The lack of an articulate explanation is not likely to be suggestive of an anticompetitive effect. Clear evidence of an anticompetitive intent, understood to mean an intent to harm consumers, may suggest an anticompetitive effect. In practice, the only intent evidence that is likely to have significant probative value is evidence of intent to respond to the conduct of professionals that causes consumers some kind of discrete and identifiable harm.

6. DETERMINING THE COMPETITIVE SIGNIFICANCE OF ANY RULE MAY REQUIRE EXAMINATION OF OTHER RULES OF THE ASSOCIATION. Although one cannot infer that all of an association's rules are anticompetitive because one rule is proven to be, the effect of any particular rule may be impossible to discern without examining the private regulatory context in which it exists. A rule may appear more or less sinister when it is viewed in relation to other rules of the association.

7. A RULE THAT HAS A PROVEN EFFECT IN ONE PROFESSIONAL SERVICES MARKET MAY OR MAY NOT HAVE THE SAME EFFECT IN ANOTHER MARKET. Empirical evidence of the effect of a particular kind of conduct restriction in one market is suggestive of its effect in another. But relevant economic characteristics will virtually never be identical across professions. Whether economic characteristics are relevant or not will depend upon the anticompetitive or procompetitive theory that underlies the effect in the market in which the effect is known. Obviously, the closer the professions are in the characteristics that drive the relevant theory, the more powerful the evidence will be.

8. AN EXPLANATION FOR A RULE WILL BE MORE OR LESS PERSUASIVE AS THE OBSERVED CONDUCT CORRESPONDS MORE OR LESS CLOSELY TO THAT PREDICTED BY THE RELEVANT THEORY. This guideline is almost too self-evident to recite. But it is so important that I shall risk insulting the reader. For example, if the theory used to explain a rule depends upon an increase in the marginal costs of supply, there has to be a convincing demonstration that the rule causes professionals to incur significantly higher marginal costs of supplying services than they otherwise would. Is the economic function to which the rule relates a significant part of the total costs of supply?

Does the rule force the professional to substitute activities that are significantly more expensive? If the theory depends upon increasing search costs, there has to be credible evidence that search costs of a substantial percentage of the buyers in the market would increase significantly by virtue of the rule. If the theory depends upon an association reducing search costs by certifying quality, there must be credible evidence that consumers look for association-affiliation when selecting a professional.

These guidelines admittedly contain no sharp edges. But then there is little steel to be found anywhere in the inquiry into the antitrust significance of professional rules. There simply is no substitute in this area for thorough investigation and tough analysis.

VI. CONCLUSION

The rules of professional associations are inviting antitrust targets. They represent formal agreements among competitors. They frequently appear to restrain commercial behavior. They are often enforced through elaborate infrastructures. And they are frequently urged upon and adopted by government entities. Therefore, they typically satisfy the legal requirements for close scrutiny. They even fulfill the conditions many economists would use to identify restraints that are likely to reduce welfare — they are horizontal, and they may be manifestations of economic capture. They are buffalo lumbering alongside the tracks of the Atcheson, Topeka and the Antitrust.

They are not what they seem. To be sure, some rules of some associations reduce economic welfare, and a subset of these undoubtedly violate the antitrust laws. A great accomplishment in recent years has been the articulation and elaboration of theories of anticompetitive harm. However, less attention, however, has been devoted to welfare-increasing explanations, which depend either on the tendency of rules to reduce the costs of supply or on their capacity to increase the quality of services rendered. In particular, rules may create an efficient system of private property rights designed to overcome vexing informational asymmetries inherent in markets for professional services. In fact, given the contexts of many rules, including their histories, the characteristics of the associations, and the structures of the markets, efficiency-enhancing explanations will often be the most powerful.

There is no easy way to distinguish between rules that increase welfare and those that do not. Consequently, modes of legal analysis that preclude consideration of factors that determine economic significance are fundamentally flawed. Hard work cannot be avoided in economics; it cannot be avoided in law. Principles of antitrust analysis can be and are best understood to permit, indeed to require, the necessary undertaking. Though some guidelines can be gleaned from the theories of benefit and injury and from the history of professional rules, in the end, they will only make a difficult task a little easier.