Department of Justice

ANTITRUST AND INNOVATION IN A HIGH TECHNOLOGY SOCIETY

Address by

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At the Celebration of
the 60th Anniversary
of the Founding of
the Antitrust Division

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I have repeatedly stated that being selected as Assistant Attorney General by President Clinton and Attorney General Reno was the greatest honor ever bestowed on me. The feelings of gratitude and pride that I felt on being sworn into Office have been reinforced as we prepared for these festivities -- the celebration of the 60th anniversary of the creation of the Antitrust Division.

Each time I look at the pictures of the former AAGs that line the walls of our conference room, I am struck by the great number of extremely accomplished people who have led the Division. Gifted academicians and leading members of the antitrust bar, they have utilized their considerable intellects and experience to promote competition as the most effective means of advancing consumer welfare. The fact that two of my predecessors subsequently served on the Supreme Court, that five others ascended to the Courts of Appeals, and two more served on the District Court, bears witness to the quality of the Division's leadership.

The nation has been particularly fortunate in recent years to the extent that antitrust policy has been influenced by the intellectual gifts and discipline that Professors Turner, Baxter, Kauper and Ginsburg brought to the Division. As a personal aside, I must tell you that I was especially thrilled to follow in the footsteps of Bill Baxter, my antitrust professor at Stanford. I don't know whether he shares my excitement about this, but in the academic tradition, I hereby absolve him of any blame for my decisions.

The Antitrust Division's outstanding reputation, however, is not solely, or even principally based on the efforts of those who had the privilege of serving as AAG. In reviewing the lists of former Deputy AAGs and Section Chiefs, one is struck by the fact that many extraordinary people have devoted substantial periods of time in advancing the Division's efforts. Over the course of this past year, I've had occasion to speak with many of them and the fondness for the Division that they've expressed to me is testimony to the fact that compensation comes in various forms.

A governmental organization, however, does not maintain an outstanding reputation over a long period of time, as has the Antitrust Division, solely because it has had a series of good leaders. The AAG and his or her assistants can declare policy and make organizational changes, but vigorous and successful antitrust enforcement is heavily dependent on the intellect, energy, and dedication of staff attorneys and economists, as well as the paralegal and clerical staffs that support them. My conversations with many alumni of the Division prior to taking Office led me to believe that I would encounter an intelligent and dedicated professional staff. If anything, they understated the professionalism and talent of the women and men who serve the Division.

Moreover, I want to take this occasion to thank the people of the Division for the warmth they have shown to me personally. Agents of change are not always made to feel welcome in large organizations, but you have given me more in the way of open-minded cooperation than I dared to hope for. The Antitrust Division has a reputation for the

balanced presentation of sophisticated legal and economic analysis in the law suits that it brings, the regulatory comments that it files, and the advice that it offers other government agencies and the Congress. To a great extent, that reputation was earned by the labor of our career attorneys and economists over many years. On behalf of myself, my predecessors in office, and consumers throughout this land, I express to them our deepest gratitude and wish that they carry on their good works.

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As proud as I am of the Division's reputation over the past 60 years, its future is my principal concern and responsibility. Today, I'd like to focus, from an antitrust enforcement perspective, on one of the seminal issues of our time -- governmental reaction to the phenomenally rapid rate of technological change. I will address three areas where the Division is dealing with the challenges of antitrust enforcement in rapidly changing markets. The first is accounting for technological change in our merger analysis. The second is our evaluation of private and governmental restraints on competition in telecommunications markets. And the third area is how we plan to address the balance between protecting intellectual property to reward innovation and maintaining competition in markets where innovation occurs.

Now, we're not the first generation to be confronted with increasingly rapid change. It's probably true that every generation since the beginning of the Industrial Revolution has worried about the impact of the changes that they were experiencing. How will antitrust enforcement

fare in our current era of rapid technological change? I don't view that as a tough question, for antitrust enforcement is designed to promote innovation. Innovation, whether in the form of improved product quality and variety or of production efficiency that allows lower prices, is a powerful engine for enhanced consumer welfare. By prohibiting private restraints that impede entry or mute rivalry, antitrust has worked to create an economic environment in which the entrepreneurial initiative that is the hallmark of the U.S. economy can flourish; it creates and maintains opportunities for bringing innovations to market.

Antitrust enforcement will remain necessary unless rapid technological change eliminates anticompetitive incentives or capabilities, and there is little reason to think it will. Dominant firms still have incentives to stifle new challenges to their hegemony, whether that has been achieved by innovation or by other means. And, it can't be demonstrated a priori that technological advance has diminished the ability of firms to restrain competition. We understand that rapid change may sometimes make the existence of market power fleeting, perhaps by expanding the boundaries of the market as advances in telecommunications have done, and we account for this in our analysis. But in other situations the cost of entering a rapidly changing high-tech industry may raise high barriers to entry, thereby enhancing the risk that incumbent firms may charge supra-competitive prices or interfere with new sources of innovation.

We recognize that research and development may involve substantial risk and need for coordination. In 1984, Congress took action

to lessen the at least perceived inhibitory effect of antitrust enforcement on joint research and development, although it did not preempt the antitrust laws and, in fact, antitrust historically rarely had challenged such joint activity. Last year, Congress took similar action with respect to joint ventures pointed towards the production process. The time has long since passed, if it ever existed, when all joint or collaborative activity among rivals was inherently suspect.

This nation's experience teaches that innovation comes from unpredictable sources -- from individuals and small firms as well as giant conglomerates. And this experience is not limited to the 19th and early 20th centuries, when change arguably occurred less rapidly. If you compare the major firms in the computer industry in the 1950s, '60s, and '70s with the major firms today, you will see that rapid technological change can create opportunities for new entrants and individual achievement. The task of antitrust is not to prejudge winners but to make sure that private restraints do not narrow the potential sources of innovation. By preserving an economic climate that allows efficient sources of innovation to prosper, be they small or large, antitrust promotes the economic and socio-political values that have been the backbone of the success of the American economy.

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For a specific application of our desire to preserve rivalry as a spur to innovation, I'd like to talk about the Division's merger policy. The 1992 Merger Guidelines do not dwell on issues of technological change,

innovation, or intellectual property. Nevertheless, the Guidelines provide a framework to take them into account in terms of market definition, barriers to entry and competitive effects. And, that's precisely what we've done. For in the long run preserving rivalry in innovation is crucial to consumer welfare.

A good example of the significance of innovation to our analysis is our recent suit against the proposed acquisition of GM's Allison Division by ZF Friedrichshafen, which would have combined their bus and truck automatic transmission businesses. The transaction would have resulted in very high levels of concentration in a few application-specific bus and truck transmission markets in the U.S. (and also in Europe). But, our concern over the competitive effects of the proposed acquisition was not limited to those narrow product markets where the two firms presently were alternative sources of supply; we were concerned as well about the effect of combining the assets used for product and process improvements and developments. The combined firm would have controlled most of the assets world-wide necessary for innovation in the production and improvement of heavy duty truck and bus automatic transmissions. In this manner, our complaint captured the scope of the feared anticompetitive effect -- innovation over the entire line of heavy-duty truck and bus transmissions, not just those few product lines that had been the subject of direct sales competition in the past.

As a general matter, we recognize that merger enforcement in markets characterized by rapid technological change raises particular issues. In many instances, evidence of significant innovation may lead to

a prediction of entry by a new firm or product. Such entry will often have the effect of deconcentrating the affected market and will lead to a conclusion that a particular transaction presents no competition concerns. Changing market conditions due to technological development may also suggest that a merger will not lead to the creation or exercise of market power. In fact, in my six months at the Division, we have seen instances where enforcement was not indicated because of the presence of such technological structural and market changes.

Technological change, however, does not always counsel against merger enforcement. Even if rapid technological change makes future market structure and dynamics uncertain, it is vitally important to preserve competition in innovation because that competition assures the best outcome for consumers. From this perspective, the antitrust enforcement interest is not based on a prediction of precisely where technological change will ultimately lead, but instead focuses on the number of potential innovators, barriers to entry and other factors relevant to competition in innovation. The Division understands that innovation competition often means duplicating R&D assets, but believes that, in particular circumstances, the benefits of competition can outweigh the unavoidable redundancies. Consistent with our allegation in the GM/ZF complaint, we believe that consumer welfare is enhanced when innovative diversity and competition is preserved.

There are those who make a somewhat different critique of antitrust merger enforcement in industries with rapidly changing technologies. In essence, they argue that economies of scale and scope are so great in

high-tech industries that, as a matter of course, mergers should be allowed even though they contravene normal antitrust standards. Although I reject that argument as a general proposition about such industries, in a particular case, it is conceivable that economies of scale or scope may justify allowing a merger that creates market power because the merger is demonstrably necessary to sustain incentives for innovation or to bring the benefits of significant innovation to market more quickly. In any event, there is room for such cases under the Division's antitrust analysis where the special facts required for such an exception can be clearly demonstrated.

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Telecommunications presents a good example of a high-tech industry subject to rapid change where antitrust policies have played and will continue to play an important and highly beneficial role. This audience, of course, is familiar with the role that the Antitrust Division played in restructuring the telephone industry through the AT&T litigation and numerous FCC filings both prior and subsequent to that litigation. The Antitrust Division was among the first governmental agencies to recognize that technological advances had significantly changed the technological and economic conditions on which prior natural monopoly assumptions were based, and the Division vigorously urged the FCC to allow and promote long distance competition. Most, if not all, would agree that we did a very good thing in leading the fight to make telecommunications more competitive. Indeed, I, along with many others, consider it the Division's most monumental contribution to the American

economy -- witness the proliferation of technology and competition in the telecommunications industry, which is profoundly altering this country's economy, and enriching the lives of hundreds of millions of Americans on a daily basis. One doesn't have to be satisfied with the competitive structure of today's telecommunications markets to view them as much improved compared to the pre-divestiture period. I believe that the Division's role in the telecommunications revolution makes it clear that the proper application of antitrust enforcement principles can promote innovation by eliminating both private and governmental restrictions on competition.

Can the same be said for the next potential revolution in telecommunications -- the effort to open, to the extent possible, local telephone loops and cable systems to meaningful and efficient competition? I think so.

We appear to be at the point where competitive options are emerging for voice, data and video services, but it is not at all clear exactly how the new services will evolve or which ones will succeed. It is not the function of antitrust enforcers to prescribe the route of the evolving information superhighway. But it is today, as it has been in the past, the function of antitrust enforcers to encourage competition and help insure a competitive marketplace, so that the route can emerge from the free play of competitive forces. It is our responsibility to assure that the opportunity for greater local telecommunications competition is not lost to private restraints, the extension of existing market power into other existing or future markets, or unnecessary governmental

restrictions. The upside potential is great, but the journey will not be without difficulty. For we start from a situation where the local telephone company still handles about 99 percent of local traffic and the local cable company possesses substantial market, if not monopoly, power in local markets. If innovation provides the opportunity for each of these technologies, and perhaps others as well, to compete efficiently in a local telecommunications market, we must make sure that no firm can use its network facilities to disadvantage rivals to the detriment of consumers of telecommunications services.

There is a delicate balance to be observed. We should not ignore the competitive risks associated with allowing entry by the local phone companies into related markets. Similarly, cable companies should not be allowed to abuse their power to deny competitive options to programmers and consumers. But, if the basis for those risks -- the local bottleneck, market dominance, or legal restrictions -- can be significantly alleviated, we should not ignore the potential competitive benefits of such entry. The goal is to promote market and regulatory conditions that, when necessary to provide competition, foster interconnection, equal access, interoperability -- you pick the term according to the setting -- of sufficient quality to allow competition to flourish on the basis of price, quality, and innovation without an inordinant amount of governmental supervision. Antitrust principles have been successfully applied to accomplish such tasks in the past. There is no reason why they can't be applied again to provide consumers with the fruits of innovation from the latest telecommunications revolution.

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When lawyers think of innovation, they tend to think of the laws protecting intellectual property, in particular patent law, but also copyright law, especially since the copyrightability of computer programs became clear. Patent law awards exclusive rights as a reward for innovation and disclosure; copyright law, less tied to innovation and disclosure, provides another form of exclusivity as an incentive to creativity. It has long been common, if not necessarily accurate, to speak of the tension between patent law and the antitrust laws, and increasingly the same is heard about copyright law and the antitrust laws.

Although these different bodies of law reflect different approaches, they both seek the promotion of risk-taking innovation to enhance consumer welfare. Some have argued that our patent and copyright systems as they function today may too sweepingly protect intellectual property, so that they may not provide a net benefit to society when their costs are taken into account. Others contend that antitrust lessens incentives for innovation by unduly restricting patentees and copyright holders, and that therefore antitrust enforcement should be preempted in this area.

The courts, with the general acquiescence of Congress, attempt to accommodate both policies, and the Antitrust Division recognizes the need to balance these concerns. Accommodation has two aspects. One, a traditional concern of antitrust, has to do with the practices of holders of intellectual property, or what we might call prerogatives, exercisable

by contract or otherwise. The second, particularly with respect to rapidly innovating industries such as computer software, is the scope of intellectual property protection.

The core rights of owners of intellectual property are reasonably clear, but beyond that core, matters are a good deal less settled. Whether the holder of a patent may, for instance, tie unpatented supplies to the patented product; engage in compulsory assignment grantbacks; or place post-sale restraints on resale by purchasers are just a few of the host of issues that have been debated and litigated in the patent/antitrust field for several decades.

I don't claim today to have final answers for the intellectual property/antitrust issues that have been the source of scholarly dispute for many years, and have led to changing enforcement philosophies in the Division. I get little guidance from decisions explained in terms of "the inherent nature" of a patent, for they often seem to substitute conclusions for reasoning. Portions of the 1988 International Guidelines relating to intellectual property appear to adopt this approach in part. I want to be clear today that we are in the process of reviewing and revising the International Guidelines for re-issuance shortly. Given my strong belief in competition, I think courts should be hesitant to read the statutory grant provisions expansively, but should recognize the anticompetitive potential of restrictive practices at or beyond the borders of the clearly conveyed statutory rights.

The substantive reach of the exclusive rights granted under the intellectual property laws also has been a matter of particular concern and ferment in the software industry. The courts and the agencies have been faced with difficult decisions about the scope of both patents and copyrights in this field, as is clear to anyone who has paid attention to the long series of important court decisions on computer software copyrights, including Whelan, Altai, and the recent decisions in Lotus v. Borland, now under review in the First Circuit. The scope of copyright protection for computer software has, we believe, important competitive implications, as well as important implications for incentives to innovate.

Similar problems have arisen concerning the scope of software patents, as the recent furor concerning the Compton multimedia patent well illustrates. The Patent and Trademark Office has recognized the considerable public debate over such questions as whether the existing framework of intellectual property laws provides the appropriate level of protection for software, and it has requested public comment on patent protection for software-related inventions. The Division is turning its attention to these questions too, and we are actively considering the ways in which we may help to assure that an appropriate concern for preserving competition as a source of innovation is brought to bear, while recognizing the need for intellectual property protection as an incentive to innovate.

Recognizing the importance to innovation of an appropriate antitrust/ intellectual property accommodation, and the inadequacy of intuitive and ad hoc responses, I have recently asked Rich Gilbert, my Economics

Deputy, to chair a task force that will consult with leading academics, practitioners, and industry experts in the field of intellectual property to review and reformulate, where appropriate, the Division's policies on intellectual property and antitrust.

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Finally, I am pleased to announce today one way in which technological change will help make the Antitrust Division more responsive to developments in these dynamic markets. As of today, those who wish to bring to our attention information about possible antitrust problems can do so through the Internet. Our address for complaints and other information is antitrust@justice.usdoj.gov, and we will read and respond to our Internet mail just as we respond to more traditional means of communications.

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For 60 years the men and women of the Division have devoted their minds and spirit to the task of allowing innovation and rivalry to flourish in markets free of unreasonable private restraints. In my judgment, they have succeeded, often brilliantly. The job, however, is not finished, and it is my difficult task and that of those who follow me to live up to the very high standards that you, in the audience, have established.

When knowledgeable people talk about the quality of various governmental agencies, the Antitrust Division is always included in a very

small group of agencies with an established tradition of excellence in public service. We thank our thousands of alumni for creating that tradition. It is our job now to live up to their legacy.