COPING WITH MARKET POWER IN THE MODERN ERA

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> "In the United States … there is much current debate about what the law against monopolization is, and should be."[1]
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> "Unilateral or 'single-firm' conduct … still vexes…. The question of the proper test that our agencies should apply to conduct of a single firm with market power now has dominated antitrust debate for several years. We are not alone…. Currently, the issue of how to evaluate unilateral conduct is the most heavily discussed and debated area of competition policy in the international arena."[2]

With a new Congress prepared to review regulatory and competition policy; America's enforcement agencies also undertaking a joint review of the application of existing policy

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[1] John Vickers, "Abuse of Market Power," Speech to the 31st Conference of the European Association for Research in Industrial Economics, Berlin, September 3, 2004. At the time he delivered this talk Vickers was chairman of the UK Office of Fair Trading.

[2] Deborah Platt Majoras, chairman, Federal Trade Commission, "The Consumer Reigns: Using Section 2 to Ensure a 'Competitive Kingdom'" at Opening Session, Hearings on Section 2 of the Sherman Act, June 20, 2006, p.3 (mimeo).

to dominant firms,[3] and an independent commission[4] doing the same; authorities in Europe re-examining past policies towards firms with substantial market power; and countries all over the world, including most notably China,[5] considering adopting or modifying competition policies;[6] it seems a good time to attempt to make a contribution to the discussion, or at least to that part of it dealing with the knotty problem of the scope of activities to be permitted to firms with substantial market power.

Americans have never been comfortable with unconstrained private power, which is why we have traditionally attempted to regulate it or, better still, adopt policies that encourage and maintain sufficient competition to reduce the effect of excessive market power on the operation of free markets and social mobility. This discomfort is sometimes quiescent, at other times noisy; sometimes a spontaneous response to an exercise of corporate power that the public finds unacceptable, sometimes a response

[3] The Federal Trade Commission and the Antitrust Division of the Department of Justice are examining "whether and when specific types of conduct … are procompetitive or benign…" Notice of Public Hearing, filed April 6, 2006.
[4] Known as the Antitrust Modernization Commission.
[5] China's cabinet, the State Council, last year approved an anti-monopoly law, but whether it is intended to be used in a manner similar to that in the US, the UK, and the EU is uncertain, since officials seem to intend to use the statute to attack the intellectual property rights of foreign companies, which they feel are being abused to prevent entry by Chinese firms. *Financial Times*, June 9, 2006 and November 11-12, 2006.
[6] Brazil is another country in which the "antitrust authorities are moving aggressively to try to break up anti-competitive behavior." But the enforcement trend is moving in the opposite direction in other countries, most notably Mexico. *Wall Street Journal*, July 13, 2005.

whipped up by office-seeking politicians for whom business-bashing seems a promising route to power of their own. It is, in other words, many things at many times.

The Modern Corporation

But one thing it is not, is new. Long before 1890, when Senator John Sherman persuaded his colleagues to adopt legislation to control the monopolies of his day, and President Benjamin Harrison signed Bill S.1 into law, Americans found it difficult to come to grips with what Irving Kristol has called the "accidental institution" that is the modern corporation.[7] Designed to permit an agglomeration of capital that would create firms large enough to take advantage of economies of scale, while limiting the liability of its investors, features that according to one historian "opened up the modern capitalist system that has brought prosperity to every society that has ever properly adopted it,"[8] the corporation is, again quoting Kristol, "a quasi-public institution … which liberal democracy never envisaged, whose birth and existence have been exceedingly troublesome to it, and whose legitimacy it has always found

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[7] Irving Kristol, "On Corporate Capitalism in America," *The Public Interest* 41 (Fall 1975).

[8] Andrew Roberts, *A History of the English-Speaking Peoples Since 1900* (London: Weidenfeld & Nicolson, 2006), 39. Roberts adds, "The way that the English-speaking peoples grasped and then perfected the idea of the corporation is the foremost key to their global success…" (p. 40).

dubious."[9] These entities were easier for a liberal democracy to accommodate when they existed for a single purpose, such as the construction of a canal, than when they became all-purpose businesses—"persons" with eternal life and virtually limitless reach. As two astute observers of the American scene put it, the power of these companies stems from the fact that "they possess most of the legal rights of a human being, without the attendant disadvantages of biology: they are not condemned to die of old age and they can create progeny pretty much at will."[10] Little wonder that they were seen as "strange, gigantic, ruthless and awe-inspiring" by the time Senator Sherman turned his attention to them.[11]

With reason. First, the corporation may be and is "a person" in the eyes of the law, but it has no form that the citizenry can identify and hold accountable. The public needs to have "real people" such as John D. Rockefeller to blame when the accretion of market power threatens the public's ability to rely on the market to protect its interests

[9] Kristol, "Corporate Capitalism." Each joint-stock company originally "existed for a very particular purpose, which needed to be defined in its statutes." Harold James, *Family Capitalism* (Cambridge, Mass. and London: The Belknap Press of Harvard University Press, 2006), 380.
[10] John Micklethwait and Adrian Wooldridge, *The Company: A Short History of a Revolutionary Idea* (New York: Random House, 2003), 2.
[11] Hans B. Thorelli, *The Federal Antitrust Policy, Origination of an American Tradition*, 226-27. First published by the Johns Hopkins Press (Baltimore) in 1954, it is now available from University Microfilms International, Ann Arbor, Michigan, Out-of-Print Books, 1992.

and welfare. Second, the modern corporation exerts substantial power, not necessarily in the market for its output, but over the lives of its employees and suppliers, as the recent downsizing of the American automobile industry indicates. Third, the modern corporation, for all its protestations of social responsibility, still has—or should have—the goal of maximizing shareholder value, whereas the smaller, often family-controlled firms it replaced could and sometimes (but far from always) did adopt a more paternalistic attitude towards their employees and the communities in which they operated.[12]

At some point in their history, corporations, already deemed worrisome institutions by many, grew to a point where they created two problems for society: control slipped from their owners to a cadre of managers whose interests were not at all times (if ever) aligned with those of the shareholder-owners; and in some cases monopoly power was acquired by means other than sheer efficiency and serving the interests of consumers. Add these problems to the other misgivings, and America's love-hate relationship with the big corporation—the entity that brings them the

[12] This is not to say that employees are in fact worse off working for the modern corporation, with its health-care plans, day-care facilities and other benefits, than they were working for the mineowners of the late nineteenth century. It is just that the corporation somehow seems more remote, more difficult to raise a fuss with, than many of the old pre-corporate entities.

benefits of economies of scale and global reach, but also seems at times beyond their control and just too powerful—becomes understandable.

The first of these problems meant that the corporation was no longer, if indeed it ever had been, a democratic institution.[13] Society was faced with organizations with capitalization and sales levels reported in numbers containing strings of digits until then only associated with governments, its owners unable to control its policies. This was brought sharply into focus when Adolf A. Berle and Gardiner C. Means published their classic, *The Modern Corporation and Private Property*.[14]

"The separation of ownership from control," they wrote, "produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear."[15] This is the agency-principal problem that has not been solved by generations of tinkering with the laws under which corporations operate, witness the current

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[13] Peter J. Wallison, a resident fellow at the American Enterprise Institute (AEI), argues that corporations "are not like political communities…. Directors owe their loyalty to the corporation itself, and [corporate law] does not permit them to represent the specific interests of shareholders the way constituents are represented in a democracy." "Are Corporation Democracies?" in *Financial Services Outlook*, AEI, December 2006, 1.

[14] First published in 1932 by Harcourt, Brace & World, reprinted with a new introduction by Murray Weidenbaum & Mark Jensen in 1968 by Transaction Publishers of New Brunswick (USA) and London.

[15] Ibid., 7.

rows over the levels and forms of compensation bestowed on executives by often less-than-independent boards. It remains the case that so-called enforcement costs—the costs to scattered owners of comparing the performance of a corporation with its potential, of appraising the competence of management, and of mounting a challenge to the existing management—give managers "considerable discretion in their choice of what goals to pursue."[16] "Considerable" but not complete, since minority shareholders are at times capable of forcing themselves unto the boards of their companies,[17] and since Mike Milken's development of financial techniques has made it easier for corporate raiders to mount takeovers of companies with slothful or self-serving managements, which might provide a workable substitute for a closer link between owners and managers in cases of major management misfeasance.[18]

This nervousness about the corporation increases when our second problem emerges—a company acquires monopoly power. Hence the body of law that constitutes

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[16] Donald A. Hay and Derek J. Morris, *Industrial Economics and Organization: Theory and Evidence* (New York: Oxford University Press, 1991), 277.
[17] For a discussion of circumstances in which separation of ownership and control does not leave managers free to operate independently of the corporation's owners, see Hay and Morris, *Industrial Economics and Organization,* 277-81.
[18] Henry G. Manne argues that the concept of corporate democracy represents an inappropriate application of a political idea to a market institution, but goes on to say that an unfettered market in corporate control "is actually a market for votes, since votes are the indicia used for control…" *Wall Street Journal Europe,* January 2, 2007.

what we call competition policy. The 1890 Sherman Act, whether conceived originally merely to maximize consumer welfare, as some contend,[19] or having broader social and political goals, as others argue,[20] did succeed in bringing some of the worst corporate actors—the "malefactors of great wealth," as Teddy Roosevelt dubbed them—to heel and, as amended, succeeded in placing limits on mergers that have the potential of substantially lessening competition.

But its critics contend that the antitrust laws have done more than constrain those worst actors; the statutes and the body of judicial decisions associated with them have often stifled "hard" competition by placing unnecessary constraints on the ability of firms with large market shares to engage in a variety of practices that are pro-competitive, for example, by creating a fear in executive suites that competitive price cuts will be deemed "predatory."[21]

This is not the place to resolve the dispute between those who worry that the antitrust laws stifle competition, and

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[19] The best statement of this position is to be found in Robert H. Bork, *The Antitrust Paradox: A Policy at War With Itself*, originally published in 1978 by Basic Books to much gnashing of teeth by economists not taken with the arguments of "the Chicago school" and others, and reprinted in 1993 with a new introduction and epilogue by Judge Bork by New York's Free Press.

[20] See, for example, John H. Shenefield and Irwin M. Stelzer, *The Antirust Laws: A Primer*, 4th ed. (Washington, D.C.: The AEI Press, 2001), 10-14. For a fuller treatment, Joel B. Dirlam and Alfred E. Kahn, *Fair Competition: The Law and Economics of Antitrust Policy* (Westport, Connecticut: Greenwood Press, 1970).

[21] Use of the laws by competitors to deter price cuts by more efficient rivals has prompted Judge Frank Easterbrook to propose that only consumers be allowed to sue for and recover damages based on any overcharges resulting from successful predation. Stephen Martin, *Industrial Economics: Economic Analysis and Public Policy*. (Englewood Cliffs, New Jersey: Prentice Hall, 1993), 482-83.

those who argue that without the constraints they impose on the use of abusively acquired market power, competition will be weakened. Suffice it to say here that the courts in the United States have consistently made clear that size alone is no offense, and that market power acquired only “as a consequence of superior product, business acumen, or historic accident” is not objectionable.[22] Authorities in the EU hold a similar view. In a recent paper they note that the purpose of their regulations is “not to protect competitors from dominant firms’ genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance, but to ensure that these competitors are also able to expand in or enter the market and compete therein on the merits, without facing competition conditions which are distorted or impaired by the dominant firm.”[23]

But it is the place to attempt to resolve another question: whether the body of competition policy that has evolved over the years can usefully be applied to the fast-changing, high-tech world of today, and if so, by whom. Those who believe that US competition policy was ill-conceived from the start will, of course, be unpersuaded by

[22] *United States v. Grinnell Corp*., 384 U.S. 563 (1966).

[23] European Commission, DG Competition, “DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses,” Brussels, December 2005, 17-18.

any argument that it remains an important policy, worth preserving, and therefore need read no further. Those who care to proceed will find this paper divided into two parts: a consideration of the applicability of competition policies forged in the day of brawny manufacturing to our economy of brainy high-tech companies; and some thoughts on the role of private parties in enforcing competition policy.

Applicability of Competition Policy to Today's Economy

Even the most casual student of antitrust policy will know that almost every change in the circumstances in which our industries operate—the emergence of large-scale manufacturing, the conglomeration movement, globalization, increased importance of research and development—has led to calls for major revisions of policy. Those who found the changes threatening would call for a tightening of policy, such as rules to limit the size of corporations, or rules that would discourage even those mergers aimed solely at diversification, rather than an increase in market power.

At other times a change in economic circumstances resulted in calls to loosen policy. When the nation was in the throes of the Great Depression, many critics of antitrust policy received a sympathetic hearing from policy makers[24] and the courts[25] when they argued that the solution to the perceived ills—low prices and high unemployment—was a relaxation or repeal of the laws that prevented businesses from conspiring to raise prices. More recently, critics of antitrust policy have been arguing that firms in rapidly changing, high-technology industries[26] must be given greater leeway in pricing and other business practices, and that globalization so increases international competition, both actual and potential, that consumers are sufficiently protected against the possibility of exploitation to make antitrust actions more or less redundant.

It is testimony to the durability of the economic concepts underlying antitrust policy that it has been able to adapt to the changes in the American economy over almost 120 years without interfering with—indeed, continuing to contribute to—the forward march of the economy.[27] Neither the increased importance of high-tech industries—if, indeed,

[24] The Roosevelt administration attempted to raise prices for agricultural and many manufactured products, and key FDR advisers such as Rexford Tugwell and Adolph Berle "believed that free market competition was impossible and a cause rather than a cure of the Depression." Spencer Weber Waller, *Thurman Arnold: A Biography* (New York and London: New York University Press, 2005), 79.

[25] In 1933 the Supreme Court allowed some coal producers to eliminate competition among themselves to provide relief to the depressed industry. *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933).

[26] I ignore here the question of just which industries are high-tech, and which are low-tech. Auto manufacturing, for example, is often cited as an example of an old, rust-belt industry, yet the use of computers and robots in manufacture surely gives it an arguable claim to high-tech status.

[27] Theodore Roosevelt's "trust-busting" was "designed to foster the free-market competition that has more than any other single factor been the key to American greatness. Roberts, *English-Speaking Peoples*, 13.

we have witnessed such a phenomenon (remember that the Standard Oil Trust was considered the high-tech company worthy by some of special treatment in the 19th century)—nor globalization requires abandonment of these core concepts.

As for new technologies: Peter Freeman, Chairman of the UK Competition Commission and a lawyer with a lifetime of experience in antitrust matters, put it after considering just how "new" the "new economy" is, "Our main concepts and tools of analysis—which are themselves becoming increasingly sophisticated and quantitative over time—are likely to remain generally suitable for the task … [of] dealing with technology issues."[28] Surely, the threat to the durability of monopoly positions from the increased pace of technological change can be accommodated by taking account of the effect of potential competition, or the "contestability" on the durability of entrenched positions.

As for the emergence of international competition, it is also easily accounted for by expanding the definition of the geographic market in which competition occurs to include

[28] Peter Freeman, "The Enterprise Act and Innovation," a talk to Confederation of British Industries Competition Conference, March 5, 2004, p.10 (mimeo). In this connection see also Robert Pitofsky, "Antitrust at the Turn of the Twenty-First Century: The Matter of Remedies," *The Georgetown Law Journal* 91, no. 1 (November 2002), 177-78. Pitofsky, former chairman of the FTC, argues that the enforcement agencies are quite able "to take the special qualities of intellectual property into account" and to prevent abuses of market power while preserving incentives of dominant firms to innovate.

sources of products with unimpeded and economic access to the domestic market.

But are these adaptations sufficient to ensure the continued relevance of traditional competition policy to so-called high-tech, global industries? This is a question surely worth considering now that these industries play such a prominent role in our economy.

The New Critics

The new critics of competition policy worry that even with realistic definitions of such concepts as the scope of geographic markets and the extent of contestability, traditional competition policy cannot cope with the fact that monopoly power, when it does emerge, is so transient that any attempt to cure it by recourse to the antitrust laws will do more harm than good. Yes, they say, some firm in a high-tech industry might use its market power to disadvantage a competitor, or to create barriers to entry, but that market power will soon wilt in the face of new technology. To take drastic measures to reduce the market power before natural market forces do the job is somewhere between futile and counterproductive.

In my view, that argument fails for two reasons. First, it ignores the fact that even if all markets are, in the long run, contestable, the long run can be very long indeed. Certainly, it can be long enough to allow a dominant firm to earn substantial monopoly profits, and to leave the corpses of several potential competitors strewn across the economic landscape, or at least to keep the survivors on life support.

Second, and more important, it is not the case that all market power is transient. Dominant firms, freed of the constraints imposed by competition policy, can engage in practices that create virtually insurmountable barriers to entry[29] and the development of more than token competition, with a consequent loss of consumer welfare. "All in all, proper R&D incentives require at least some potential competition. In a stable monopoly position, the incentives for R&D are limited,"[30] writes one scholar—and nothing stabilizes a monopoly position so much as uninhibited ability to deploy the weapons naturally associated with market power. Or, as three international scholars recently put it after an extensive review of the economic literature, "It seems to

[29] It should be noted that defining barriers to entry is no easy task. A good summary of the difficulties confronting the antitrust analyst can be found in Harold Demsetz, "Barriers to Entry," in *The Organization of Economic Activity* (Oxford, UK and Cambridge, Mass.: Basil Blackwell, 1989), vol. 2, chap. 2, 25-39.
[30] Marcus Glader, *Innovation Markets and Competition Analysis: EU Competition Law and US Antitrust Law* (Cheltenham, UK and Northampton, USA: Edward Elgar, 2006), 47. For a good discussion of the positions taken by various economists on the relation of competition to innovation see pp. 38-48 and Martin, *Industrial Economics*, 369-371.

us that there are no strong normative conclusions in this literature to calm the apprehensions of those who have never been persuaded that the unregulated activity of large, dominant firms which characterize many modern markets has benign effects on welfare."[31]

In recent articles and in conversations with several distinguished economists skeptical of the desirability of unsheathing the antitrust sword to slay the monopoly dragon, the case of AT&T was raised.[32] The new and, it should be noted, many not-so-new critics, point out that what the courts tore asunder the market is now reconstituting through a series of mergers of local and long-distance telephone companies. Had we only let the market work its magic, we would have been spared the costs associated with recourse to the legal system.

This analysis fails to take account of several important facts. AT&T in its pre-break-up form undeniably had very substantial market power, some of it garnered by coercing independents.[33] Although "the list of new technologies created by [the] Bell [System] … is impressive," and

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[31] David Encaoua, Paul Geroski and Alexis Jacquemin, "Strategic Competition and the Persistence of Dominant Firms: A Survey," in *New Developments in the Analysis of Market Structure*, ed. Joseph Stiglitz and G. Frank Mathewson (Cambridge, Mass.: The MIT Press, 1986), 75.
[32] See especially Robert W. Crandall and Clifford Winston, "Who Needs Antitrust," *Wall Street Journal*, March 9, 2006.
[33] Jonathan E. Nuechterlein and Philip J. Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* (Cambridge, Mass. and London: The MIT Press, 2005), 5-6.

employees of the Bell Labs did feel “we were part of a holy crusade to improve the world’s communications and thereby to improve the lot of man,”[34] as a former employee points out, my observation is that AT&T executives managed technological change at a measured pace, designed to preserve the value of the company’s existing assets and to allow it to preserve its vertically integrated structure. A combination of its ability to manage—some might say “game”—the regulatory process,[35] and performance that compared favorably with the then-dismal performance of foreign telecom companies, many of them state-owned, kept the public and politicians sufficiently satisfied to prevent a clamor for removal of barriers to entry. AT&T prohibited “foreign attachments” such as answering machines, or any device not manufactured by its subsidiary, Western Electric.

After the break-up—and not only because of it, to be sure—the pace of change accelerated in a way that would have been impossible under the old regime. According to one careful study that doesn’t stint in its praise of the

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[34] Edward E. Zajac, “Technological Winds of Creation and Destruction in Telecommunications: A Case Study,” in *Evolving Technology and Market Structure: Studies in Schumpeterian Economics*, ed. Arnold Heertje and Mark Perlman (Ann Arbor: University of Michigan Press, 1990), 257.

[35] “In long-distance services, Bell sought to retard competitive entry by urging the Federal Communications Commission (FCC) to forbid it…”.F.M.Scherer and David Ross, *Industrial Market Structure and Economic Performance*, 3rd ed. (Boston: Houghton Mifflin Company, 1990), 462. But note that the presiding judge rejected the government’s regulatory-abuse theory, contenting himself with expressing doubts about the ability of the FCC effectively to regulate a company of the size and scope of AT&T.

accomplishments of Bell Labs, AT&T "sometimes failed to put the ensuing inventions to use, either because they threatened to undermine current revenue streams or because management did not appreciate the inventions' potential in the marketplace."[36] It is one thing to say that new technologies would have eroded AT&T's market power—eventually; it is quite another to demonstrate just how potential entrants would have been able to raise capital and begin the arduous task of confronting a firm with the regulatory nous, market power, and attendant political power, of the integrated Bell System.[37]

Because of the dissolution of that system, competitors had space in which to develop, so that we now have wireless telephony, voice-over-internet, and at least a few competitors vying for consumer favor. Alfred Kahn, a close student of regulatory and competition issues, lists the following as achievements of the deregulation that followed dissolution of the old system: a sharp fall in long-distance rates; more efficient price structures; "a proliferation of

[36] Nuechterlein and Weiser, *Digital Crossroads,* 389.
[37] The evidence about the effect of AT&T's integrated monopoly on the rate of innovation is mixed. The best analysis is to be found in Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, 2:295-305. First published in 1970-1971 by John Wiley & Sons, it was republished in 1988 by The MIT Press.

telecommunications services and equipment"; and increased efficiency.[38]

The reconsolidation that we are witnessing is not a restoration of the old monopoly power, but an attempt to put together an entity capable of coping with the competition that sprang up after the AT&T breakup, partly as a result of that change in structure, partly as a result of the rush of technology. If this analysis is correct, successful antitrust enforcement can reasonably claim some credit for the advances in telecom competition, and associated innovation, since the dissolution of the AT&T monopoly.

So the lesson of AT&T is not that the dissolution was a useless application of competition policy.[39] The lesson is that a dominant firm, able to control the pace of innovation, did just that, and when its dominance was ended by application of antitrust policy, massive leaps in innovation occurred.

This came as no surprise to students of the history of antitrust policy. F.M. Scherer notes that during the period of Standard Oil's dominance (the company held 80 percent of U.S. refining capacity in 1880) innovation as measured by patenting activity was lower than in earlier periods, but that after the company's dissolution into 34 fragments, "there is

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[38] Ibid., "Introduction: A Postscript, Seventeen Years Later," 2nd ed., xix-xxiii.
[39] For a contrary view see Alan Stone, *Wrong Number: The Breakup of AT&T* (New York: Basic Books, Inc., 1989).

new growth and substantial increase in the lever of patenting."[40]

<u>Market Dominance and Innovation</u>

Moreover, if innovation is indeed now more than ever an important driver of productivity and, therefore, of advances in our standard of living, it is more important than ever that dominant firms not be allowed to control the pace at which innovations are developed and introduced by deploying tactics that create barriers to entry or artificially limit the growth of firms that do succeed in wedging themselves into the market.

I would proceed from that reasonable assumption to another, equally reasonable in my view: rapid diffusion of innovation can be assured only by preserving a competitive marketplace. There is no denying that "despite the very extensive literature on the subject, the issue of the links between market power and innovation is still not settled."[41] As between those who argue that only large firms have the

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[40] F. M. Scherer, "Technological Innovation and Monopolization," paper submitted to the FTC/DOJ Hearings on Single Firm Conduct, April, 2006, p. 6. The extent to which patents increase the rate of innovation is, of course, hotly debated. A good summary of views can be found in Kay Withers, "Intellectual Property and the Knowledge Economy," a paper published as part of the Institute for Public Policy Research's project "Intellectual Property and the Public Sphere: Balancing Competing Priorities," December 2005, pp. 10-14, http://ippr.typepad.com/ip.

[41] George Symeonidis, *The Effects of Competition: Cartel Policy and the Evolution of Strategy and Structure in British Industry* (Cambridge, Mass. and London: The MIT Press, 2002), 224.

optimal scale for innovation, and those who argue that dominant firms have little incentive to innovate, I come down on the side of the latter.

First, any sensible comparison of economies in which competition policy exists and is enforced, with economies in which cartels and national champions are encouraged, must lead a dispassionate observer to conclude that competition produces superior economic performance. An econometric study by economists at the Federal Reserve Bank of New York concludes, "Greater competition produces large effects on macroeconomic performance…. Lower levels of competition are associated with significantly reduced output and consumption and home and abroad…"; had the EU adopted the more deregulatory and competitive US model, its output would be some 12.4 percent higher.[42]

Second, studies comparing the innovation records of dominant firms with those in more competitive industries generally contain an intrinsic bias in favor of the former. These studies are observing the behavior and performance of the dominant firms operating under the constraints imposed by competition policy. For that reason, these studies provide no basis for conclusions about the

[42] Tamim Bayoumi, Douglas Laxton and Paolo Pesenti, "Benefits and Spillovers of Greater Competition in Europe: A Macroeconomic Assessment," Federal Reserve Bank of New York Staff Report no. 182, April 2004, abstract and pp. 3 and 30.

effectiveness of competition policy in producing more rapid innovation: remove the constraints, and the dominant firm might well see little reason to maintain its previous pace of innovation, confident that if a competitor rears its head, it will be able to lop it off with tactics not now permitted.

Third, most of these studies fail to capture the role of venture capitalists in financing upstarts. These capitalists, the first port of call for a newcomer after he has exhausted his own and his family's resources, are notably hard-headed realists. If they believe that an entrenched incumbent will be allowed to snuff out incipient competition by inducing manufacturers to boycott the new product, or by using technological legerdemain to tie its own competing product to its monopoly product, or by setting a pricing schedule that in effect results in full-line forcing,[43] venture capitalists will, at the very least, raise the cost of capital to reflect the enhanced risk, and more likely suggest to the newcomer that completion of his doctoral dissertation or a job with the entrenched incumbent is his best option. They must always be satisfied, before opening their wallets, that the incumbent does not have sufficient market power to nip the competition in its incipiency. Potential suppliers cannot be threatened

[43] John Vickers, "Abuse of Market Power," p. 20, notes that a dominant firm can raise rivals'costs—unduly deny scale economies to rivals—by offering price reductions that are "*conditional* on the buyer not dealing with rivals."

with retaliation if they do business with the newcomer; most distributors cannot be fearful of the consequences of dealing with the new entrant; the dominant incumbent cannot manipulate its price schedules so as to make it uneconomic for its customers to divert part of their custom to a new entrant. Only with the assurance that the law protects their investment from being washed away by such tactics that have nothing to do with the relative merits of the competing products, will venture capitalists write the checks the challenger needs.

They know what some academic analysts do not: experience suggests that dominant firms are willing to have recourse to tactics that are related to their market power, rather than their efficiency. The use of these tacticsturns the battle into one in which the firm with greater market power wins, rather than the firm with the best mousetrap. It is those tactics that the antitrust laws, applied both by the enforcement agencies and private parties, are uniquely equipped to prevent.

- A firm with substantial market power, even power fairly won in the marketplace, cannot leverage that power by tying other products to the one that it dominates.

- A firm with substantial market power cannot use that power to pressure customers not to deal with its competitors, or impose supply allocations and/or a pricing system that accomplishes that same result.
- A firm with substantial market power over a product, access to which is crucial for firms that compete with it in other product markets, cannot make access conditional on an agreement by its potential competitors to cede other markets to it.

Surely, nothing in the current economic thinking, or in the nature of high-tech industries, makes such restrictions on the tactics available to dominant firms obsolete. Indeed, such constraints on the use of market power are more compelling in the case of industries in which waves of creatively destructive innovation are to be relied on as the principal engines of progress.

Adaptation To A High-Tech Economy

That's why it would be folly to abandon or seriously weaken the competition policy that has contributed so much to the growth of the American economy and has conferred on us the socially stabilizing consequences of a policy that promises the upwardly mobile a fair field with no favors. Of course, antitrust policy will have to be applied with the economic sense that has enabled it to remain a viable tool for the preservation of competition for over a century. That will require that at least three areas of enforcement be applied with sensitivity.

- If it is indeed the case that high-tech products have short economic lives, that fact will have to be factored into any appraisal and measurement of market power. Antitrust policy has never been aimed at demonstrably transient market power, and I see nothing in current enforcement policies that gives reason to fear that it will be in the future.
- The question of relief will have to be given even greater consideration in the future than in the past. The notion that the antitrust laws are proscriptive rather than prescriptive is less compelling than it once was: if an enforcement agency doesn't know what remedy to propose, it should stay its hand. And that remedy cannot always rely on ongoing judicial supervision of the practices of a company specializing in the creation of intellectual property, for two reasons. First, we do not want to slow the pace of innovation to accommodate the more leisurely one of the judicial process. Second, it is not at all certain that the

courts can cope with firms understandably reluctant to comply promptly with their orders, witness the recent confession of the judge in the Microsoft case that the remedies she had ordered are not working terribly well.[44] This difficulty with behavioral solutions may mean that relief would have to be more radical in the case of high-tech violators of the antitrust laws than in the case of lower-tech ones, with divestiture and structural solutions playing a larger role relative to the prohibition of specific practices.

- The business practices of dominant firms will have to be more carefully scrutinized to separate legitimate applications of efficiencies from the application of market power. Practices requiring the closest scrutiny include pricing policies that make it uneconomic for customers to divert business to new entrants, that create covert tying of new products to those in which the firm has a dominant market share, and that offer supply assurance only to customers who demonstrate their "loyalty" by taking their full requirements from the dominant firm.

[44] Judge Colleen Kollar-Kotelly of the US District Court for the District of Columbia expressed dissatisfaction but added after a new approach had been agreed upon, "My only wish is that it had been done earlier, so we wouldn't be at this point," that being the point at which "Microsoft still has not provided the documentation to competitors" that the decree demanded, according to Thomas Vinje of Clifford Chance LLP.

All of these potential barriers to entry must be examined closely, lest “high-tech” be converted to “my-tech” by dominant firms. Application of these principles will not be easy. It never has been. But we know enough about how to measure dominance; how to appraise business practices to determine which have as their intent and effect preservation of market power, and which are genuinely competitive weapons related solely to efficiency; how to include such factors as the presence of international competition; and how to account for the effect of technology on the durability of market dominance, to continue to use the antitrust laws to make certain that consumers get to determine who wins the competitive race.

<u>Private Enforcement</u>

If enforcement of competition policy is, indeed, important to continued improvements in consumer welfare—call it our standard of living, to use a more familiar term—it would seem self-evident that supplementing the limited resources available to public-sector[45] authorities with those of the private sector makes sense. As Phillip Areeda put it, provisions for private actions “enlist plaintiffs in the work of

[45] The UK Office of Fair Trading reckons that it has resources sufficient to allow it to pursue only 20-25 cases per year.

detecting, punishing, and thereby deterring wrongdoing."[46] The European Commission agrees. In a recent paper it argued that "facilitating damages claims for breach of antitrust law will not only make it easier for consumers and firms who have suffered damages arising from an infringement of antitrust rules to recover their losses from the infringer but also strengthen the enforcement of antitrust law."[47]

An army of private enforcers, enlisting help from attorney-entrepreneurs free to accept cases on a contingency fee basis, is an important supplement to the limited resources of the enforcement agencies. The number of private actions brought under the antitrust laws historically has exceeded by far the number brought by the government. True, many of these follow successful government-initiated actions, but it is also true that private cases account for 90 percent of competition enforcement actions[48] and, according to the estimate of one practitioner/scholar, that some 80 percent of court decisions establishing important principles

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[46] Phillip Areeda, *Antitrust Violations Without Damage Recoveries*, 89 Harvard Law Review 1127 (1976).
[47] Cited in the *Financial Times*, January 19, 2006.
[48] Irwin M. Stelzer, "Thoughts on Competition Policy, lecture delivered at the Second Oxford Antitrust Law Conference and reprinted in *Lectures on Regulatory and Competition Policy*, p.25. See also the *Financial Times*, September 13, 2004, "Brussels Aspires to US-Style Litigation."

(not all of which I find agreeable, I might add) in the competition policy area have resulted from private actions.[49]

A less obvious but equally important reason that private enforcement is so important is that it is free of direct political influence. In America, administrations come and go, some more given to a jaundiced view of the activities of dominant firms than others,[50] witness the soft settlement worked out with Microsoft when the Bush administration took office and control of the Department of Justice, and rid itself of the meddlesome Joel Klein, the head of the Antitrust Division. As Robert Pitofsky has noted, “The Department of Justice and the FTC during the Clinton years did bring cases that would not have been considered during the Reagan years and probably would not have been brought during the first Bush administration.”[51]

In Britain, governments come and go, and not all future governments might be as wedded to the concept of political independence for regulators as is the current one. In the EU, Neelie Kroes, the current competition commissioner, has breathed new life and considerable sense into EU

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[49]Estimate by Max Blecher in an e-mail communication to the American Antitrust Institute, October 6, 2006.

[50] “When it comes to many types of antitrust enforcement …the [Bush] administration has taken the most relaxed and least aggressive approach since the last years of the Reagan presidency.” Stephen Labaton, “New View of Antitrust Law: See No Evil, Hear No Evil,” *New York Times*, May 5, 2006.

[51] Robert Pitofsky, “Antitrust at the Turn of the Twenty-First Century,” 169 (first cited in note 28).

competition policy,[52] but there is no guarantee that her successor will follow the same path.

The private sector suffers no such swings in attitude—the businessman who believes he has been the subject of an anticompetitive act by a dominant competitor has equal access to the courts no matter who controls the White House, Congress, Parliament, or the European Commission. Politicians' motives vary; the survival instincts of private entrepreneurs never change.

Unlike some enforcement agencies, private litigants are not subject to the political pressure that incumbent dominant firms, which often have large numbers of employee/voters in key congressional districts, can at times bring to bear on enforcement agencies.

This contribution of private actions is especially important at this time, for several reasons. First, enforcement policy is in flux, with serious policymakers, including our Department of Justice and FTC, musing about the way competition policy should be applied to the practices of dominant firms. If that musing results in a greater official tolerance of acts once deemed likely to reduce competition,

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[52] The EC competition directorate, known in the trade as DG Comp, was recently voted the antitrust agency most admired by other enforcement agencies, and by lawyers, economists, and executives. *Financial Times*, July 7, 2006.

we will have to rely increasingly on the private sector to carry the antitrust torch.

Second, the practices of dominant firms have become so sophisticated that attempts to separate legitimate competitive instruments from anti-competitive behavior are more difficult than ever. After all, potential monopolists have come a long way since the days of John D. Rockefeller and other crude practitioners of the art of monopolization, and since Alcoa thought it a good idea to buy up all the available hydroelectric sites to deny potential competitors access to needed electrical energy.

In the face of this sophistication, administrators of our antitrust laws might feel cowed by the complexity of these issues, might not feel competent to tell what sort of practice is exclusionary or predatory. But the private victims most certainly can. And the private enforcement route gives them an opportunity to state their case, and the courts an opportunity to apply their judgment to the facts of the case, against a background of traditional market share, profit-sustainability, entry history and other important “facts on the ground.”

Third, as noted above, we are in a period in which the glamour of “high tech” is blinding the eyes of some enforcement agencies. They are being asked to believe that sauce for the old economy goose is not sauce for the new economy gander. Not so. Indeed, since technological change is a more and more important driver of productivity growth, it is important that powerful incumbents in those industries not be allowed to engage in practices aimed at preventing or slowing incursions of technologically superior challengers. And who better to reveal the effect on competition than a competitor, injured by illegal anticompetitive practices, conversant in the technical jargon, on the sharp edge of customer relations, well-informed of the details and consequences of the dominant firm's practices, and with the incentive both of survival and a damage award to impel him to action?

In short, now more than ever—in this age in which enforcement agencies suffer from constrained resources, in this age in which enforcement agencies might find it daunting to come to grips with the complexities of markets in high-tech industries, in this age in which dominant firms are increasingly sophisticated in the anticompetitive weapons they deploy—it is important to preserve and enhance the role of private enforcement in giving added strength to competition policy.

That is not to say that the process cannot be abused—either by well-heeled competitors using the courts as part of their competitive strategy, or by nuisance suits filed in the hope of a quick settlement. But there is good reason to believe that the benefits of keeping open the private-action route to redress outweighs the possible costs of unwarranted litigation.

The cost of bringing such a suit is not trivial. An established rival contemplating bringing an action has to reckon with the possibility that large in-house and outside attorney and expert fees will prove to be money wasted, and therefore will be disinclined to act unless reasonably certain of his ground, or that the impact on his rival is worth a substantial expenditure. And less well-heeled potential litigants must persuade the lawyer/financier acting on a contingency fee basis that the law firm stands a relatively good chance of being compensated for its efforts—a good chance of winning. Frivolous law suits provide no such favorable odds. Still, there is a risk of abuse, but in my view it is outweighed by the losses that would result from seriously weakening this enforcement weapon.

Finally, and at the risk of upsetting those who believe that competition policy should be about efficiency and only efficiency, and should not pursue the social objective of contributing to upward mobility and an open society, I should point out that man does live by bread alone, that our competitive economy is more than a machine to grind out more and more products at better and better prices, laudable as that objective is. During the debate on the Sherman Act, its sponsor referred to the situation in which "a humble man starts a business in opposition to them [the trusts], solitary and alone" and is forced out of business by a monopolist's predatory acts:

> Why, sir, I know of one case where a man In good circumstances, a thrifty, strong, healthy American was … met in just the way I have mentioned. If he had the right to sue this company in the courts of the United States under this section[53] he would have been able to indemnify himself for the losses he suffered.

Congress was well aware of the imbalance of power between powerful incumbents and their challengers. "This section opens the door of justice to every man, whenever he may be injured by those who violate the antitrust laws," noted Congressman Webb of New York in a 1914 debate on the antitrust laws.

[53] Section 7 of the original Sherman Act, now Section 4 of the Clayton Act, created a private right of action not present under the common law.

So we cannot ignore the fact that underlying the policy of encouraging private enforcement lies a deep sense that equity demands just such a policy, that the preservation of open markets creates upward social and economic mobility and diffuses economic and hence political power, keys not only to the maintenance of competition, and to continued increases in productivity and material well-being, but to the maintenance of an economic system that is fair, and is seen to be fair.

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