

# The Second Edition of Judge Posner's *Antitrust Law*: A Tempered Appreciation

**Donald J. Boudreaux**

In the last part of the 20th century antitrust was transformed from an internally conflicted regulatory regime into a coherent one. Whereas thirty years ago there was no consensus on the ends that antitrust law should serve, today most agree that antitrust should aim to promote long-run consumer welfare. Conflicting goals—such as protecting small producers from the competition of larger, more-efficient firms, or keeping industries unconcentrated as a means of nurturing democratic values—are no longer taken seriously as appropriate aims of antitrust.

Three scholars were instrumental in sparking this transformation: Aaron Director, Robert Bork, and Richard Posner. (Honorable mentions go to Harold Demsetz and the late Yale Brozen.) Director didn't write much, but his intrepid use of the economic way of thinking in his classes at the University of Chicago Law School taught generations of students (including Bork) that competitive forces are astonishingly robust. His outside-of-the-box (or, more precisely, outside-of-the-textbook) analyses of facts and institutions made clear two vital features of reality. First, actual methods of competition are enormously varied; they are far greater, and more creative, than those few methods depicted in textbooks. Second, competition is no fragile flower but, rather, a sturdy oak that finds sustenance in places and in ways unimaginable to professors, judges, politicians, and bureaucrats. Director's triumph was sealed with the 1978 publication of Bork's *The Antitrust Paradox*, which brilliantly applied Director's lessons to all major areas of antitrust policy.

The impact of Bork's book was enhanced by the publication, two years earlier, of a more subdued and more tightly reasoned book: Posner's *Antitrust Law: An Economic Perspective*. Though sharing Bork's dissatisfaction with the reigning antitrust jurisprudence, Posner seemed less exasperated than Bork with the policy. The tone and the careful, constructive attention to detail that infused Posner's book indicated that he didn't see antitrust law as quite the mess that Bork thought it was. Bork wrote an exposé of the foolishness that motivated so many antitrust decisions during the first three-quarters of the 20th century; Posner patiently identified the various costs and benefits that should be considered by officials aiming to use antitrust to promote competition.

Posner more than Bork carefully explained the types of economic theory and evidence that should guide the application of antitrust law. Although Bork never called for the outright repeal of antitrust legislation, his book persuaded many that a drastic shrinkage of the scope of antitrust was needed. No such radical spirit animated Posner's book. Posner endorsed (and continues, in the second edition, to endorse) significant changes in antitrust practice, such as aligning states' authority to bring antitrust suits with that of private plaintiffs. But he seems genuinely to believe in the necessity and promise of antitrust grounded in sound, Chicago economics.

The two books—Posner's and Bork's—worked in tandem. Bork convinced the reader that antitrust law had been applied in an abysmal fashion. But just as the reader despaired, Posner offered hope

■  
**Donald J. Boudreaux** is  
Chairman, Department  
of Economics  
George Mason  
University.

with his clear, usable, and sound guidelines to make antitrust economically more respectable. Without Bork, I doubt that the potent prescriptions offered by Posner would have been heeded as readily as they were. Without Posner, judges deciding antitrust cases likely would have continued flailing away, ungrounded in positive economics.

The importance of this change in antitrust doctrine cannot be overstated. Antitrust is vastly better than it was when Bork and Posner published the first editions of their books. And it is vastly better largely because of these two books.

So, is any great purpose served by a second edition of Posner's book? Apparently no, but actually yes. Apparently no, simply because the amount of damage now inflicted on the economy by confused antitrust doctrines is today less than in 1976. At the margin, Posner's second edition cannot do as much good as the first edition because much of the good that could be done has already been achieved by the first edition.

Actually yes, because antitrust is still a dangerous doctrine that can easily revert to being the anti-consumer swamp that it was for most of its history. To minimize the risk of this reversion requires a mind such as Posner's to reinforce the message that antitrust ought to be firmly grounded on core economic principles. For this reason alone, the second edition is welcome, particularly the new chapter on "The New Economy," in which he nicely reveals the significance of the fact that the new economy is so heavily grounded on intellectual property. As long as there is antitrust, consumers should be comforted that Judge Posner continues to devote his strong intellect to it.

*But should antitrust*

*continue? On this*

*question I part*

*company with Posner.*

But *should* antitrust continue? On this question I part company with Posner. Based on my understanding of competition, as well as on the fallibility (and the unavoidable political nature) of government enforcement of antitrust statutes, I believe that consumers would be better served if all such legislation were repealed and if antitrust enforcers found other jobs. In the second edition of *Antitrust Law*, Posner acknowledges that a minority of scholars endorses outright repeal, but he dismisses their arguments summarily.

Posner first says that, as a practical matter, repeal isn't going to happen. This claim may be a sound prediction for the next few decades. But it is not an intellectually respectable argument against the case for repeal. Political prospects ought not deflect scholars from going where their reasoning and the empirical evidence take them. Many seemingly permanent policies have been undone, arguably because of the intellectual efforts of scholars unafraid to write for the ages. Adam Smith endorsed free trade in the face of the seemingly invincible forces of mercantilism; Ludwig von Mises and F. A. Hayek attacked the very foundations of socialism when enthusiasm for central planning was at a fever pitch and socialization of industry was sweeping Europe. Milton Friedman and Martin Anderson, among others, patiently argued for outright abolition of the military draft when it seemed entrenched.

Posner's second reason for dismissing the case for repeal is more respectable: He believes that the benefits of economics-guided antitrust outweigh the costs. Certainly, antitrust informed by Posnerian reasoning is better than antitrust was before Posner arrived on the scene. But Posner wrongly concludes that the benefits so clearly exceed the costs that we can reject the case for repeal.

One important objection to antitrust policy is that enforcement authorities lack sufficient knowledge to consistently promote competition. Posner plays down this argument by claiming that "economics is an improving discipline" (p. x). I'm not convinced. Economists certainly publish more articles featuring more rigorous mathematical and econometric techniques, but it is difficult to make an empirical case that our understanding of the relevant area of economics, competition, has improved

much over the past three or four decades. For example, the fact that a game theorist builds a model showing that the first firm that enters an industry can price its product strategically to prevent entry says surprisingly little about reality. How likely is such an outcome? The evidence, in my view, is that most of the theoretical possibilities that have been discovered recently are highly unlikely to appear in the real world. (For evidence that these theories lack empirical value, see John R. Lott, *Are Predatory Commitments Credible?* 1999; and Stanley J. Liebowitz & Stephen E. Margolis, *Winners, Losers, and Microsoft*, 1999.) Adding to the stock of clever theoretical possibilities is not necessarily an improvement in economic understanding.

Still, economic understanding *has* improved. Nearly all improvements in our understanding involve the discovery that private arrangements reliably overcome problems (real and imaginary) that the blackboard theorist and the government official believe can be solved only by government intervention. Such is the nature of the significant improvements promoted by Director that characterize most of what is distinct about the Chicago school. This understanding counsels in favor of repealing antitrust.

Almost all of the original bases for antitrust intervention have been shattered by sound economics. Price-cutting is no longer an obvious means of monopolizing; bigness is no longer believed to be inevitable, inevitably harmful, or perpetual; and the myriad contracting arrangements devised by actual market participants are increasingly understood to enhance competition despite having been ignored by authors of textbooks. The advances that have occurred in economic theorizing are generally abstruse demonstrations of theoretical *possibilities*. Only when these theories have been supported by solid empirical findings should they serve as the basis for policy, particularly in light of the overwhelming evidence demonstrating the robustness of competition. The most important developments in economics tend to show that unregulated markets are likely to remain competitive—and that regulation is likely to be used in antisocial ways.

*Almost all of the original bases for antitrust intervention have been shattered by sound economics.*

Posner appears unconcerned about the potential for antitrust to be used for anticompetitive, rent-seeking purposes. He finds the evidence for this point to be inconclusive. In contrast, as I read the record, two important facts loom. First, antitrust has been, in large part, a weapon for rent-seekers to wield against their entrepreneurial rivals. (For the most comprehensive collection of this evidence, see Fred S. McChesney & William F. Shughart, eds., *The Causes and Consequences of Antitrust*, 1995.) This fact remains, regardless of the motives or level of economic understanding of the politicians who enacted antitrust statutes. Second, Aaron Director's instincts were sound: competition is robust and generally takes place regardless of private attempts to squelch it. These two facts convince me that the costs of antitrust likely outweigh its benefits.

I challenge Judge Posner and others who continue to believe that antitrust serves a useful, pro-consumer function to point to unambiguous instances of monopolization, by a private firm (or firms) unaided by government-enforced barriers to entry, that harmed consumers.

Instances of collusion among rivals might be cited—for example, some railroad cartels of the 1870s and 1880s. But even such least-objectionable antitrust targets are not justified by a great deal of evidence showing that, absent antitrust enforcement, collusion would be serious problem. (Even the railroads felt the need to press for the formation of the Interstate Commerce Commission to enlist government in the cause of railroad cartelization.)

My challenge is especially relevant for all areas of antitrust apart from collusion among rivals, because a great deal of antitrust doctrine and theory amounts to a search for the unicorn of sustainable market power. Is there a single merger that was permitted that experience shows to have created a monopolist that harmed consumers for any length of time? Is there an instance of predatory pricing that was never legally challenged—or that was challenged unsuccessfully—that suc-

ceeded in winning for the price-cutter long-standing monopoly power? Is there an example of contracting between a firm and its downstream customers or upstream suppliers that has succeeded in creating genuine monopoly power?

To be sure, people can disagree on the meaning of “length of time” and “monopoly power.” But I can think of no instance in which failure to apply antitrust sanctions against such firms or practices resulted in anything that I (or a consensus of economists) would call monopoly power. I can think of many instances in which the dynamic forces of entrepreneurial competition wiped out the large market shares, or reduced to insignificance any fleeting monopoly power, that apparently invincible firms once enjoyed. Recall Detroit’s Big Four automakers—and A&P—and IBM—and even J.D. Rockefeller’s Standard Oil Company which, contrary to popular myth, lost its market share principally because of competition from rivals rather than because of the antitrust attack it suffered.

The evidence compels me to conclude that antitrust is unnecessary.

Two responses to my conclusion might be made. First, perhaps antitrust enforcers have let no potential problem slip through their net; every potentially serious problem was challenged either by private plaintiffs or by government. Massive amounts of evidence show, however, that antitrust enforcers are far from perfect in distinguishing plausible from implausible sources of monopoly power. The only realistic way that antitrust enforcers could have ensured against committing Type II errors (missing monopoly power when it does exist) would have entailed committing plenty of Type I errors (finding monopoly power when none exists)—and, thus, frequently punishing firms for competing. Such punishment is a sizable wrench to chuck into the machinery of the competitive market process.

Second, perhaps the abuses of private monopolies never materialize and, hence, never become part of the visible evidence because the very possibility of antitrust enforcement assures that they never, or only seldom, occur. Perhaps. But in light of antitrust’s long record of abuse and ignorance, it’s fair to ask for at least *some* hard evidence that markets require antitrust intervention to remain competitive. (To demonstrate the costs of monopoly, should it occur, is not to demonstrate that monopoly is a significant problem in reality.)

Despite the impression that the reader likely gets from reading Judge Posner’s book and almost all other books on antitrust—the evidence that markets are prone to monopolization is extraordinarily weak, whereas the evidence that antitrust is used to hamstring competitive rivals is powerful.

So long as antitrust law exists, it should be tempered by sound economics. Judge Posner continues to be among the most articulate and indefatigable champions of keeping antitrust so tempered. At the end of the day, however, he is too timid in using his razor-sharp economic instincts to critically explore antitrust’s foundations. If he were to overcome this timidity, I’m confident that the third edition of his book would exhibit greater skepticism of antitrust and a correspondingly greater appreciation of the robustness of competitive forces. ●

# Antitrust After the Interception: Of a Heroic Returner and Myriad Paths; A Review of Richard Posner, *Antitrust Law* (2d ed. 2001)

**Michael A. Carrier**

Judge Richard Posner deserves as much credit as anyone for making the interception. The interception, that is, of the dubious hail mary cases thrown by antitrust courts in the 1960s—cases in which courts pursued multiple, conflicting objectives and promoted small businesses at the expense of consumers.<sup>1</sup> Judge Posner, along with other members of the “Chicago School,” hauled in the interception by powerfully touting economic efficiency as the sole goal for antitrust. We now find the author running back the interception return, headed towards the end zone of an antitrust regime characterized by coherent, “economically rational” doctrine and enforcement (p. viii). And at least for the first few yards of the return, which cover the ground of the goals of antitrust, the “Post Chicago School” blocks for Judge Posner, relieving him of the task of making the case for an economic approach to antitrust. We are far indeed from 1976, when the title of the first edition of his book, *Antitrust Law: An Economic Perspective*, implied the possibility of other perspectives (p. vii.).

Before reaching the end zone, however, the return confronts imposing obstacles, such as the enforcement and administration of the antitrust laws, and the lightning speed of the new economy. This review evaluates Judge Posner’s success in confronting these obstacles, as he leads the reader on a tour (whose structure this review will follow) (1) “to explain the economic approach to new generations of lawyers and students,” (2) “to update the approach in light of theoretical advances since the mid-1970s,” and (3) “to apply it to the new issues of antitrust law that have emerged in the last quarter century” (p. viii.).

## **Description: The Economic Approach and Tour of the Case Law**

Judge Posner succeeds as few, if any, do in explaining economic concepts. Throughout *Antitrust Law*,<sup>2</sup> he deftly uses economic theory to illuminate various business practices. He also offers a straightforward, conversational writing style, and a no-holds-barred analysis of judicial (primarily Supreme Court) opinions.

Judge Posner begins with the economic theory of monopoly, and continues by leading the reader on a wide-ranging tour of the building blocks of the antitrust landscape: price fixing, divestiture, mergers, exchanges of information among competitors, vertical restraints, and exclusionary practices such as tying, predatory pricing, vertical integration, exclusive dealing, and boycotts. A few examples of his didactic instruction include his explanations of (1) the economic basis of monop-

■ **Michael A. Carrier** is Assistant Professor, Rutgers University School of Law - Camden. He thanks Steve Calkins, Herb Hovenkamp, and Bill Kovacic for helpful comments.

<sup>1</sup> See, e.g., *Albrecht v. Herald Co.*, 390 U.S. 145, 152–54 (1968); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *United States v. Von’s Grocery Co.*, 384 U.S. 270 (1966); *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

<sup>2</sup> RICHARD A. POSNER, *ANTITRUST LAW* (2d ed. 2001).

oly, founded upon the seller's power over price and its operation in the elastic portion of the demand curve, where additional increases in price would lead to a greater "proportional reduction in the quantity demanded" than the "proportional increase in price" (pp. 9–12); (2) the difficulty, in evaluating predatory pricing claims, of determining whether a firm sells at less than its marginal cost, since such a measurement "does not appear on a firm's books" but "is a hypothetical entity" (pp. 204, 218); and (3) the capacity of vertical restraints, such as territorial restrictions and resale price maintenance, to prevent free-riding but also, perhaps, to reflect the manufacturer's status as "the cat's paw of cartelizing dealers" (pp. 172, 184–85).

Judge Posner also elucidates the evolution of antitrust doctrine by revealing the roads not taken: the economic analysis of pricing that lost out to "proof that the defendants had conspired" (since "lawyers and judges are more comfortable with conspiracy doctrine") in the law of price-fixing (p. 53), and the inability to "measure elasticities [of demand] reliably by the methods of litigation," which resulted in the dominant influence of market definition in antitrust law (p. 148). And he explains the prevalence of tying cases that involve patents by referencing the development of the doctrine of patent misuse, where the issue "was whether the patentee had improperly extended the patent monopoly by monopolizing an unpatented product tied to the patented product" (p. 198).

The tour of economic practices would not be complete without pointing out courts' now-repudiated monuments to earlier, less-economically-oriented eras. The carcasses on the side of the road are legion: *Columbia Steel*, *Brown Shoe*, *Von's*, the "scandalous" *Simpson*, the "feeble" *Schwinn*, and *Utah Pie*, to name just the most battered.<sup>3</sup> (Pp. 120, 122–29, 180–81, 186–87, 221, 223.) Another heap of cases and doctrines on the road to disrepute follows, with any life within them exceeding their usefulness, according to our tour guide: divestiture as a Section 2 remedy, over-broad conceptions of barriers to entry, the potential competition doctrine, submarkets, the *Hardwood* case, *Maple Flooring*, *Colgate*, the per se rule against resale price maintenance, and Kodak's aftermarkets.<sup>4</sup> (Pp. 73–74, 111, 114–15, 143–44, 152, 161–67, 178, 189, 236–37, 242.)

But Judge Posner refuses to join the "pessimists" who question a role for antitrust today (p. ix). He dismisses as "academic" proposals "to curtail antitrust enforcement drastically or even to repeal the antitrust laws altogether" (p. x). And he recognizes the "substantial . . . potential social gains from an effective antitrust policy" (p. 17), concluding that antitrust doctrine is "sufficiently supple" to cope with problems presented by the new economy (p. 256).<sup>5</sup>

### Revision: Responding to the Theoretical Advances of the Past Twenty-Five Years

The next obstacle confronting Judge Posner is more menacing. For now that we all speak the economic language of antitrust, the issues are more nuanced. In exploring Judge Posner's success

---

<sup>3</sup> *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967).

<sup>4</sup> *American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *Maple Flooring Mfrs.' Ass'n v. United States*, 268 U.S. 563 (1925); *United States v. Colgate & Co.*, 250 U.S. 300 (1919); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). Most of the cases that Judge Posner discusses in the second edition appear in the first edition.

<sup>5</sup> For example, he differs from Robert Bork, see ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 149–55, 299–309 (1978), in recognizing that firms might occasionally employ practices such as predatory pricing or exclusive dealing as rational profit-maximizing tactics (pp. 194, 210–11, 252–53).



in updating *Antitrust Law*, four developments introduced (or revitalized) by the Post-Chicago School are illustrative: (1) more elaborate applications of game theory, (2) the “raising rivals’ costs” theory, (3) attention to unilateral competitive effects from horizontal mergers, and (4) new perspectives on barriers to entry.<sup>6</sup>

**Game Theory.** Analysis based on game theory—the antecedents of which trace back to the nineteenth century “granddaddy” of the Cournot equilibrium<sup>7</sup>—has burgeoned in the past two decades. In fact, game-theoretic analysis underlies many of the Post-Chicago School contributions, including the next two developments discussed in this section. Stated at its most basic level, the analysis posits that firms’ optimal actions incorporate the anticipated reactions of their competitors, and vice versa.

Judge Posner raises game theory in two contexts. In discussing oligopoly pricing, he notes that game theory models “do not yet yield implications that differ from those of non-game-theoretic approaches” like those advanced by George Stigler in the 1960s (pp. 59–60). And in the realm of predatory pricing threats, he advises the reader that the conditions required for the theory to operate are too exacting, which offers “a clue to the limited inroads that such analysis has made in antitrust thinking” (p. 212).<sup>8</sup> It is true that the theory has failed to provide courts with a readily-applicable set of tools. But perhaps game theory is more helpful than Judge Posner acknowledges. At a minimum, it provides a structure for systematizing anecdotal evidence of collusion and imposes discipline on economists to specify firms’ “strategic variables, [] timing, and [] information structure.”<sup>9</sup> And it could supplement Judge Posner’s seventeen characteristics identifying markets propitious for collusion (pp. 69–79) by incorporating factors such as the likelihood of punishment facing firms that deviate from the (tacit) cartel agreement in repeated games.

**Raising Rivals’ Costs.** The profusion of Post-Chicago scholarship on game theory is second only to the ink spilled on the “raising rivals’ costs” (RRC) theory. A firm raises its rivals’ costs “by restraining the supply of inputs available to rivals, thereby giving the purchaser power to raise prices

---

<sup>6</sup> The “game theoretic analysis of strategic behavior forms the core” of the Post-Chicago approach, see Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 518 (1995); the raising-rivals’-costs and unilateral-competitive-effects-from-horizontal-mergers theories are two of the most important contributions of the Post-Chicago School, see Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 337; and “[t]here is perhaps no subject that has created more controversy among industrial organization economists than that of barriers to entry,” see W. KIP VISCUSI ET AL., *ECONOMICS OF REGULATION AND ANTITRUST* 158 (1995).

Judge Posner also addresses the “aftermarkets” hatched out of the Supreme Court’s holding, in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 481–82 (1992), that a manufacturer in a competitive “primary” market could have monopoly power in the “secondary” market of the servicing or parts of its own equipment. He explains that the pricing of replacement parts is an example of price discrimination, and not otherwise a concern, since “[t]he seller who exploits his ‘monopoly’ over replacement parts will find himself without many purchasers of his original equipment in the next period” (pp. 236–37).

<sup>7</sup> The model posits that “each firm in the market is assumed to choose the quantity to produce that will maximize its profits, given that every other seller is doing the same thing” (p. 307).

<sup>8</sup> For example, where a monopolist seeks a reputation for predatory pricing, game-theoretic analysis would question the likelihood of such a tactic based on the exacting conditions of a finite number of potential entrants and a prescribed sequence in which they can enter. In that situation, the last entrant “knows that the monopolist will not engage in predatory pricing against him because . . . there are no more potential entrants to deter” (p. 211). The next-to-last entrant also “knows that the monopolist will not engage in predatory pricing” against it “because the only effect of doing so will be to bring on” the last entrant (p. 212). And, after a process of backwards induction, the first potential entrant will enter and “the monopolist will not engage in predatory pricing” (p. 212).

<sup>9</sup> Drew Fudenberg & Jean Tirole, *Understanding Rent Dissipation: On the Use of Game Theory in Industrial Organization*, 77 AM. ECON. REV. 176 (1987); see Franklin M. Fisher, *Games Economists Play: A Noncooperative View*, 20 RAND J. ECON. 113, 120 (1989).

in its output market.”<sup>10</sup> Judge Posner traces the origin of RRC back to Aaron Director and Edward Levi, initial founders of the Chicago School, who observed that a monopolist might profitably “decide to impose additional costs upon itself for the sake of a restriction’ on suppliers or customers ‘if the effect of it would be to impose greater costs on possible competitors’” (p. 251 (citations omitted)). And Judge Posner takes leave from others in the Chicago School by conceding the possibility that the practice “can be an effective method of predation” (p. 197).

His argument against RRC, however, fails to persuade. As an initial matter, the example he offers to demonstrate the theory’s hypothetical nature utilizes a firm that lacks monopoly (or, to be precise, monopsony) power (p. 197). This alone ensures that it does not present a “plausible case[] of exclusionary practices” (p. 195). More fundamentally, Judge Posner advises the reader that RRC “is not a happy formula” since it “is neither a necessary nor a sufficient condition of predation” (pp. 196–97). Such a proclamation, however, proves less than initially meets the eye. RRC obviously is not a necessary condition of predation; all this says is that there can be other types of predation besides RRC, such as predatory pricing, which, even if it forces a competitor to sell below cost, does not raise its costs. Additionally, RRC—like any practice that is exclusionary in some, but not all, cases—is not a sufficient condition of predation because a firm often will raise its rivals’ costs simply by being more efficient. But the proof of these two negatives does not dispense with RRC as a potentially viable theory.<sup>11</sup> A more persuasive critique would be that any ray of illumination that RRC shines on otherwise-hidden anticompetitive practices is lost in the glare of the searchlight that cannot distinguish between predatory and exclusionary conduct.<sup>12</sup>

**Unilateral Competitive Effects.** The third development, the “unilateral competitive effects” theory of horizontal mergers, is not mentioned in *Antitrust Law*. The Horizontal Merger Guidelines explain that “[a] merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level.”<sup>13</sup> With Judge Posner’s gaze transfixed on the prevention of the “collusive pricing” that could be facilitated by “high levels of concentration in a market” (p. 118), this omission is not surprising. Nonetheless, it is disappointing, for the reader is not treated to the author’s thoughts on relatively recent advancements in the agencies’ evaluation of mergers such as the use of computerized point-of-sale scanner data. By directly shedding light on sellers’ demand elasticities, such a tool could render market definition less vital. Judge Posner eagerly desires such a development, expressing hope that “a considerable simplification of antitrust litigation” would result from studies that “use elasticity estimates to estimate market power directly” (p. 71 n.30). But his abrupt conclusion that such a project is improbable (pp. 71–72, 147–48) leaves the reader wondering how he would have utilized tools such as scanner data.<sup>14</sup>

<sup>10</sup> Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs To Achieve Power over Price*, 96 YALE L.J. 209, 224 (1986).

<sup>11</sup> Nor does Judge Posner’s proposed test for exclusionary practices, which asks whether practices “exclude . . . an equally or more efficient competitor,” trace this distinction since (1) RRC focuses not only on *exclusion* of a rival from the market, but also on the raising of the costs of a rival that remains in the market, and (2) his test would allow, for example, practices that impose on less-efficient firms barriers to entry in the form of economies of scale that increase “the optimum monopoly price” (p. 225). See *infra* text succeeding note 16 for a discussion of Judge Posner’s periodic sympathy for expansive conceptions of barriers to entry.

<sup>12</sup> Cf. Stephen Calkins, *Comments on Presentation of Steven C. Salop*, 56 ANTITRUST L.J. 65, 66 (1987) (explicating the “fifteen or more steps . . . needed to find a violation” in a “summary illustration” of RRC based on *Klor’s Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959)).

<sup>13</sup> U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 2.21 (1997).

<sup>14</sup> For a discussion of Judge Posner’s incomplete treatment of the FTC’s successful challenge to the Staples-Office Depot merger, which was



*The myriad proposals*

*that Judge Posner lays*

*out in Antitrust Law*

*reveal the author's*

*command of the*

*material of antitrust.*

*The downside is that*

*Judge Posner often*

*substitutes breadth for*

*depth, failing to fully*

*explore ramifications*

*of his proffered*

*tests such as their*

*interdependence and*

*administrability.*

**Barriers to Entry.** The final development involves barriers to entry, an issue on which commentators have markedly different perspectives. The Chicago School, for one, has embraced a steadfastly skeptical position on such barriers—that they, for example, are “ghosts that inhabit antitrust theory”<sup>15</sup>—thereby reducing the likelihood of finding anticompetitive activity. In contrast, the Post-Chicago School is more likely to find such barriers in economies of scale, advertising, and irreversible investments.<sup>16</sup> In *Antitrust Law*, Judge Posner articulates the standard Chicago School approach. He informs us, in a passage on the effect of new entry on the likelihood of collusion, that he has “deliberately avoided using the term ‘barrier to entry,’” which is commonly used expansively “to mean any obstacle that a new entrant must overcome in order to gain a foothold in the market,” such as “the capital costs of entering the market on an efficient scale” (p. 73). Such a use is “dubious” since “the firms already in the market must incur expense to remain there [and] must continuously overcome, therefore, the same hurdle that faces a new firm” (p. 73). It naturally follows, then, that even if economies of scale (not to mention vertical integration, advertising, and the amount of capital required for entry) “increase the length of time required for new entry,” they nonetheless “do not create a barrier to entry” (pp. 74, 114–15).

But Judge Posner then reverses course: economies of scale “may sometimes . . . create a barrier to entry” (p. 74). They may “increase . . . monopoly profits [by] forestalling new entry” (p. 252). They may, through “bundling and tying . . . forc[e] the entrant to enter with a more complex product,” which could “slow[] or deter[]” entry (p. 236). And they may, by delaying entry, “tend to increase the optimum monopoly price,” which is “presumptively inefficient” (pp. 2, 225). While there obviously are two sides to the debate, the author’s conflicting positions leave the reader disoriented.

### **Prescription: New Tests, the New Economy, and New Administration**

**New Tests.** The myriad proposals that Judge Posner lays out in *Antitrust Law* reveal the author’s command of the material of antitrust. The downside is that Judge Posner often substitutes breadth for depth, failing to fully explore ramifications of his proffered tests such as their interdependence and administrability. It also is curious that he makes so many proposals given that he believes that antitrust doctrine is “in pretty good shape” (p. 266).<sup>17</sup>

An abbreviated review of Judge Posner’s tests will focus on his proposed standard for exclusionary practices.<sup>18</sup> A plaintiff must prove that a defendant with monopoly power employed a practice that is likely to exclude from its market “an equally or more efficient competitor”; the defendant can rebut such a finding by showing that the practice “is, on balance, efficient” (pp. 194–95). A brief glance at courts’ current potpourri constituting Section 2 analysis—which, depending on

---

based in part on econometric analysis of pricing data, see Jonathan Baker, *Horizontal Merger Analysis Grows Up: A Review of Chapter 5 of Richard Posner’s Antitrust Law* (2d ed. 2001), ANTITRUST SOURCE, Jan. 2002, at 3–5, <http://www.abanet.org/antitrust/source/jan02/baker.pdf>.

<sup>15</sup> BORK, *supra* note 5, at 310.

<sup>16</sup> See Jonathan B. Baker, *Recent Developments in Economics that Challenge Chicago School Views*, 58 ANTITRUST L.J. 645, 651–52 (1989). The Harvard School also relied on such barriers, according to Judge Posner, in condemning tie-ins, vertical integration, resale price maintenance, and persistent concentration in certain industries. See Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 934–39, 945–47 (1979).

<sup>17</sup> See also p. viii (“Today, antitrust law is a body of economically rational principles largely though not entirely congruent with the principles set forth in the first edition.”).

<sup>18</sup> This section also addresses his proposals for vertical mergers and efficiency-generating exclusionary practices. Judge Posner offers additional tests for collusion (pp. 69–93), the propriety of divestiture (p. 102), information exchanges among competitors (pp. 169–70), price discrimination (p. 205), predatory pricing (pp. 216–17), boycotts (pp. 240–41), and unilateral refusals to deal (p. 242).

the case, focuses on the defendant's intent, a change in the market, denial of an essential facility, harm to a competitor, or some other factor—demonstrates the promise of Judge Posner's test, which could advance a more justifiable, economically-grounded analysis. But the test would have benefited from further development. One problem is that Judge Posner does not reconcile this general test with several approaches he propounds for *specific* exclusionary practices. For example, without incorporating the concept of "an equally or more efficient competitor," the test for vertical mergers focuses on the defendant's intent, and the analysis for exclusionary practices that also offer efficiencies (which is raised in the discussion of the new economy) looks to whether a practice is "employed widely in industries that resemble the monopolist's but are competitive" (pp. 228, 253).

Administrability also presents a concern. How exactly will we know if a competitor is "equally or more efficient"? Judge Posner offers only one example, in which a monopolist's lowering of its price towards (but not below) cost would exclude a less efficient firm (p. 196). Turning to the rebuttal, how are we to calculate whether the practice "is, on balance, efficient"? Judge Posner himself recognizes the intractability of this undertaking elsewhere (as detailed in the margin),<sup>19</sup> but does not explain how such arduous and error-laden inquiries are ameliorated when incorporated into his proposal.<sup>20</sup>

Another administrative difficulty, and an example of a proposal with surprising consequences, involves the burden-shifting construct utilized in the test for exclusionary practices that offer efficiencies. The defendant can use the practice if it is "employed widely in industries that resemble the monopolist's but are competitive" (p. 253), and the plaintiff can rebut this presumption by demonstrating that "forbidding the use of the practice will, by increasing the rate or speed of new entry, completely offset the effect of the prohibition on the monopolist's costs" (p. 254). Judge Posner does not explain how to balance the lowering of costs brought about by earlier entry against the benefits of adopting practices apparently efficient in other industries. And the failure to fully develop the analysis leads to the result that the defendant will *lose* an exclusionary-practices case if the plaintiff can show that the benefits of new entry equal the costs to the defendant of not implementing the practice.

**The New Economy.** By "new economy," Judge Posner refers to the manufacture of computer software, the provision of services by Internet-based businesses, and the communications services and equipment that support the first two industries (p. 245). He lucidly sketches the characteristics of the new economy: falling average costs, modest capital requirements, dramatic innovation, quick and frequent entry and exit, network effects, standardization, path dependence, and switching costs (pp. 245–50). And he illustrates the powerful position held by a monopolist with an intellectual-property-protected product in a network effects market (p. 249). It is heartening to learn that Judge Posner believes that antitrust doctrine is "sufficiently supple" to cope with the new economy, as he sets off to determine how to adjust antitrust enforcement, focusing on the use of neutral experts and streamlined trials (p. 256).

---

<sup>19</sup> Determining whether conduct "produced a benefit equal to or greater than the harm caused" would "impose a heavy burden on the courts and the parties" and would lead to "frequent . . . mistakes in application, making the solution somewhat illusory" (p. 268); "[b]alancing the costs and benefits of an exclusionary practice that also has efficiency characteristics may well be beyond the capacity of the courts" (p. 253); "it is very difficult to measure the efficiency consequences of a challenged practice [a]nd so throughout this book we shall [endeavor not] to compare directly the gains and losses from a challenged practice" (p. 29).

<sup>20</sup> Incongruity also can be found in Judge Posner's test for vertical mergers, which prohibits those made with "an exclusionary or otherwise improper intent" (p. 228), despite his earlier exhortation that "[a]ny doctrine that relies upon proof of intent is going to be applied erratically at best . . . [in part because] the availability of evidence of improper intent is often a function of luck and of the defendant's legal sophistication, not of the underlying reality" (p. 214).

The complexity of the issues presented by the new economy, according to Judge Posner, calls for expertise. In particular, the author advocates the use of competent neutral experts or “an ad hoc technical committee composed of two party-nominated and one neutral technical expert” that would assist the judge in administering a consent or litigated decree (pp. 277–78). Although these are only partial solutions—he acknowledges that the neutral expert (of whom “there may be very few” (p. 277)) cannot resolve many of the issues, which involve “imponderables” and “are not problems simply to be solved by the application of the relevant economic principles” (p. 279)—they are worth considering.

His second suggestion is of even greater import. Judge Posner is exactly right that “law time” is not the same as “new-economy real time,” with the result that antitrust cases involving new-economy firms “may drag on for so long relative to the changing conditions of the industry as to become irrelevant, ineffectual” (p. 279). His solution is to streamline trials. Rather than hew to the “Anglo-American court trial, unchanged in their essentials for centuries” with each party getting to put in its evidence, and the sequence proceeding through direct, cross, redirect, and recross examinations, Judge Posner proposes an “agreed-upon narrative of the relevant facts” jointly prepared by the parties, with trials limited to the disputed issues (pp. 283–84).<sup>21</sup> This could potentially be a promising solution to one of the most intractable difficulties with antitrust litigation. But the proposal would have been even stronger if Judge Posner had engaged the obvious counterargument.

The need to quickly resolve cases always strolls hand in hand with longstanding, significant “constraints” on judicial efficiency, constraints that serve important purposes. Rather, however, than “balance expedition against due process,” as Judge Posner identifies the project (p. ix), the reader is treated only to the expedition side of the ledger. But the fundamental principle of due process cannot be diminished by linking it with the “2000 presidential postelection mess” (p. 279). This is not to say that expedition should not ultimately emerge triumphant; it is to say that before we anoint it the victor, we must account for due process. Judge Posner also seems to modestly overstate matters in claiming that “much of the trial is taken up with evidence not addressed to any issue in dispute but introduced simply in order to create a favorable atmosphere” (p. 283). One can imagine a case, for example, in which the search for the defendant’s intent—needed for Judge Posner’s tests on vertical mergers (p. 228) and predatory pricing (p. 216)—will encompass an array of witnesses and documentary evidence that go to the “issues in dispute.”<sup>22</sup>

***New Administration and Enforcement.*** In addition to the proposals designed for the new economy, Judge Posner offers three ambitious ideas for improving antitrust administration and enforcement: (1) simplify the statutory framework, (2) adjust the remedies available for violations, and (3) limit the role of the states in bringing antitrust lawsuits.

First, he suggests simplifying the “almost entirely superfluous” statutory structure (p. 259). His preferred choice would be “a simple prohibition of unreasonably anticompetitive practices,” though he also contemplates repealing all of the antitrust statutes except Section 1 of the Sherman Act, which “is sufficiently broad to encompass any anticompetitive practice worth worrying about that involves the cooperation of two or more firms,” or, alternatively, Section 2 (pp. 259, 260). As an ini-

---

<sup>21</sup> Cf. Stephen Calkins, *In Praise of Antitrust Litigation: The Second Annual Bernstein Lecture*, 72 ST. JOHN’S L. REV. 1, 40 n.170 (1998) (discussing FTC rules changes designed to minimize trial delay (1) by requiring parties, at prehearing conference, to submit proposed stipulations of law and fact, and to designate testimony to be presented by deposition, and (2) by encouraging written submissions of direct examinations of experts).

<sup>22</sup> It also is unclear whether the expedited approach would apply to only antitrust trials or (to pick two other potential settings) patent infringement lawsuits involving Internet business methods and litigation involving e-commerce contracts.

tial matter, it is not clear that this game is worth the candle: Judge Posner recognizes that “the courts have . . . succeeded in largely though not entirely erasing the statutory differences that have no basis in sensible antitrust policy” (p. 264). In particular, he points out that “the *Alcoa* approach is no longer the law”; “*Standard Stations* has gone down the tubes”; the consideration of exclusive dealing arrangements requires “the most careful weighing of alleged dangers and potential benefits”; and mergers, predatory pricing, and tying are “treated the same” under various statutory provisions (pp. 263–64).

But even if the courts had not practically erased the statutory differences, Judge Posner’s proposal would not offer benefits commensurate with the costs of completely revamping the statutory structure. Take, for example, the author’s most “attractive alternative”: prohibiting “unreasonably anticompetitive practices” (p. 260). Even if such a proposal relieved courts of the task of justifying and reconciling multiple statutes, it would have no effect on two more pressing concerns. First, as Judge Posner admits, it would “allow for categorizing some practices as per se illegal and others as requiring more extended inquiry” (p. 260), thus inviting the *exact same* categorization problems that plague antitrust analysis today, where more attention often is paid to placing an activity into a particular category than to analyzing its competitive effects. Second, it is unclear how to apply such an indeterminate test. “Unreasonably anticompetitive” does not solve any cases.<sup>23</sup> So in those cases that do not involve per se analysis, some type of “more extended inquiry”—be it full rule of reason, “quick look,” or something else—is warranted. Given that, as detailed above, Judge Posner’s proposals for analyzing particular practices are themselves subject to significant administrability concerns, the statutory simplification (even assuming, contra the current state of the law, a pressing need therefor) would not address the fundamental difficulties underlying antitrust analysis today.

For his second improvement, Judge Posner tackles the antitrust remedial system, the purpose of which is deterrence, and the penalty for which should equal “the cost that [the violator’s] violation imposed on society” (pp. 266–67).<sup>24</sup> The author recognizes that his approach “will not work well in cases in which the social costs of a violation are very difficult to quantify” (p. 268). But all he offers in support of his proposal are examples for which the social cost cannot easily be measured: mergers (for which it is “extremely difficult” to “measur[e] the increase in market price that the merger [] brought about”) and price fixing (for which he offers proxies such as the defendant’s profit, since it “of course is not true [that] the social costs of price fixing could be determined without difficulty”) (pp. 268–70). The one example that “present[s] less of a dilemma,” exclusionary practices, does so because the focus for that category is on the “costs [for] *competing* firms,” which “bears no necessary relation to the social cost inflicted by the practice” (p. 268 (emphasis added), p. 270). Moving on from this rough beginning, the author proceeds to offer insights on the criminal sanction of imprisonment (which is a deadweight loss to society and imposed too rarely to be a deterrent), fines (which are inadequate), and treble damages (which overdeter for mergers and most exclusionary practices and underdeter for concealable offenses such as price fixing) (pp. 270–72).

---

<sup>23</sup> Nor does the proposal that retains the monopolization offense where such a term “mean[s] simply conduct that unjustifiably promotes supra-competitive pricing” (p. 260).

<sup>24</sup> Although Judge Posner does not define the concept in the discussion on remedies, the reader learns elsewhere that the social cost includes not only “deadweight loss” but also monopoly profits and the costs “incurred in the process of seeking and resisting monopolization” (pp. 16–17, 292 n.1, 299). In addition, the concealability of certain offenses, which “drives the probability of being punished for committing the violation below 100 percent,” requires “the punishment cost . . . of the [] violation [to be] raised above the social cost” (p. 269).

*Judge Posner's*

*suggestions address*

*the crucial question*

*of how to mobilize*

*the cumbersome*

*machinery of antitrust*

*litigation to confront*

*the nimble,*

*Schumpeterian*

*new economy.*

Third, Judge Posner calls for the states to be “stripped of their authority to bring antitrust suits, federal or state” except for situations “in which a private firm would be able to sue”; for example, where firms conspire to raise the price of goods sold to the state (p. 281). Although he laments the states’ “free rid[ing] on federal antitrust litigation” and “poor quality” of the lawyering in many of the offices of state attorneys general, Judge Posner’s principal concern appears to be the “excessive[] influence [of] interest groups that may represent a potential antitrust defendant’s competitors” (p. 281). In this regard, the state system, according to Judge Posner, fares worse than the federal, which is not plagued to nearly the same degree by such groups because the federal enforcement agencies are “dominated by lawyers most of whom go on to jobs in the private sector” and so “must demonstrate their professionalism” (p. 285).<sup>25</sup>

Judge Posner’s argument is subject to question from two angles. First, he presumes that interest groups representing competitors can have only a negative effect on antitrust enforcement. But such an assumption requires support, in particular because he has recognized (a) that competitors (because of their access to information and “stake in antitrust enforcement”) might be “antitrust enforcer[s]” who at least are “more efficient” than consumers<sup>26</sup> and (b) that “injured competitor[s]” should be able to file damages suits against “predator[s]” since such suits would “provide adequate deterrence” of exclusionary practices (p. 268). Second, focusing on a revolving door between private law firms and the federal enforcement agencies does not dispense with charges of interest group influence on the federal level since (1) it is precisely *because of* the revolving door that, as Judge Posner earlier recognized, government lawyers may wish “to gain trial experience of an amount and at a level of responsibility usually denied young [attorneys] in private firms”<sup>27</sup>; and (2) the position represents an about-face for the author, whose earlier writings on the subject were not quite so sanguine, contending (a) that the performance of the FTC “has been gravely deficient throughout its entire history”<sup>28</sup>; (b) that the agency has been “guided more by solicitude for parochial interests than by consideration for the general welfare”<sup>29</sup>; and (c) that enforcement at the Antitrust Division is in the hands of trial lawyers, who “tend to be combative . . . young or mediocre, or . . . zealots,” certainly “not the right people to be the custodians of the government’s antitrust policy, [which] is what they are.”<sup>30</sup>

<sup>25</sup> Judge Posner also points to the role of federal judges, who are insulated from interest-group pressures because of their secure tenure and, curiously, “broad discretion [resulting from] the open-endedness of the major federal antitrust statutes” (p. 285).

<sup>26</sup> RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 345 (5th ed. 1998).

<sup>27</sup> Richard A. Posner, *The Federal Trade Commission*, 37 U. CHI. L. REV. 47, 86 (1969); *see also id.* (further noting that “[t]he value of [FTC staff attorneys’] trial experience to future employers is unaffected by whether the cases tried promote or impair the welfare of society”); Richard A. Posner, *A Program for the Antitrust Division*, 38 U. CHI. L. REV. 500, 533 (1971) (trial lawyers at the Antitrust Division “owe their authority and independence . . . partly to the accumulation of skills and experience that makes them valued by private firms”); *cf.* POSNER, *supra* note 2, at 111 (government lawyers “derive . . . career advancement from the trial of an antitrust case”). A greater receptivity to interest groups’ entreaties does not lie far from the quest for trial experience.

<sup>28</sup> Richard A. Posner, *The Federal Trade Commission*, *supra* note 27, at 82.

<sup>29</sup> *Id.* at 83. *see also id.* at 85–87 (“the personal goals of FTC members and staff”—which include “retain[ing] their jobs . . . obtain[ing] greater appropriations for their agency . . . [and] gain[ing] trial experience”—“influence the character and direction of the Commission’s activity”); *id.* at 84 (“the structure of incentives operating on the members and staff” of the FTC is an “obstacle” to improvement of the agency); *id.* at 85 (because it is “extremely difficult to evaluate . . . the performance of regulators,” it is “possible for them in many instances to bend their regulatory duties to the service of personal interest”).

<sup>30</sup> RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 231 (1976). Even if the passage of time and changes in the agencies softens these positions, a somewhat-weakened apprehension of such concerns still rises at least to the level of persuasiveness of the revolving-door hypothesis.

\* \* \* \* \*

To a significant extent, Judge Posner's three objectives in *Antitrust Law* reflect the critical obstacles confronting the interception return that heads towards the end zone of a coherent system of antitrust doctrine and enforcement. The author successfully evades some of the tacklers: he guides the reader on a lucid economic tour of business practices and cases, and offers an array of ambitious proposals covering the entirety of the antitrust landscape and bespeaking an impressive knowledge of the field. Judge Posner's return also confronts recent theoretical advances in the field; here, he neglects some of the significant developments offered by the Post-Chicago School and does not fully engage others. And finally, the returner is losing ground to other tacklers ready to pounce on his proposals: administrability, counterarguments, and contradiction.

But Judge Posner breaks free from perhaps the most dangerous tackler: the new economy. As he darts towards midfield, we should throw a few blocks for him. For Judge Posner's suggestions address the crucial question of how to mobilize the cumbersome machinery of antitrust litigation to confront the nimble, Schumpeterian new economy. We owe it to antitrust to consider his proposals seriously, to ensure that the discipline remains an agile participant in, rather than helpless bystander outside, the new economy. ●



## The Future of Ideas: Antitrust and Intellectual Property in the Information Age

### David H. Evans

In his new book, *The Future of Ideas: The Fate of the Commons in a Connected World*,<sup>1</sup> Professor Lawrence Lessig offers his view of the future of the Internet, innovation and, ultimately, of ideas themselves. It's grim. To Lessig, the Internet over the last decade fostered an explosion of creativity and innovation. This explosion occurred principally because the Internet was content and distribution neutral. This neutrality liberated artists and inventors because it reduced dependence on entrenched providers to distribute their ideas. This liberation created a creative commons.

Now, however, the Internet is becoming commercialized. Private interests are attempting to insert proprietary standards and protocols into the structure of the Internet. These proprietary standards and protocols will allow those interests to eliminate the neutrality, control content, and constrain the innovation the original Internet encouraged. Further hampering innovation, the expanding protections granted intellectual property holders are increasingly constricting the ability to build on and improve ideas. As business method and software patents proliferate and copyright protection is extended beyond what is necessary to stimulate innovation, inventors are more and more barred from using the ideas required to innovate. Ultimately, the future of ideas is at risk.

In essence, Lessig believes that the traditional balance between the grant of the right to exclude to induce innovation and society's benefit from seeing the invention has tilted too far to the inventor's advantage. He does not see much of a role for antitrust in helping to restore the balance. Lessig's solutions to these problems are regulatory. He feels that the government should force the Internet to be content and distribution neutral. He also advocates a radical rethinking of the intellectual property laws. He believes that a moratorium should be placed on new business method and software patents while they are studied for their effects on innovation, and, in any event, should be more narrow in scope and duration. He also believes that copyrights should be available only by registration and have a limited number of renewable terms.

Lessig's worries are legitimate. The power of the Internet is its neutrality, and if commercial interests are successful in creating proprietary "bottlenecks" that they can exploit, that "bottleneck power" will influence how the Internet operates, perhaps detrimentally. Intellectual property rights do seem to be expanding at an astonishing pace. When a company can claim a patent on an essential functionality of the Internet, intuitively, it will have an effect on innovation. Indeed, though Lessig does not say it, the structure of his analysis is modern antitrust.

His solutions miss the mark, however. With regard to potential bottlenecks, his assumption is that there are no viable alternatives to government regulation. Antitrust is a viable alternative. Antitrust

■ **David H. Evans** is an attorney with the law firm of Jones, Day, Reavis & Pogue, in Washington, D.C., and chairs the Internet Committee of the ABA Section of Antitrust Law. The author's views are his own and not necessarily those of Jones, Day, Reavis & Pogue, its partners or clients.

---

<sup>1</sup> LAWRENCE LESSIG, *THE FUTURE OF IDEAS: THE FATE OF THE COMMONS IN A CONNECTED WORLD* 2001.

forbids the illegal exercise of monopoly power. If companies create and exploit bottlenecks, they are subject to redress under the antitrust laws. Perhaps his aversion to antitrust derives from a view that antitrust is too slow to capture anticompetitive behavior in the information age. Once a company has caused a network market to tip, for example, it is difficult to re-balance that market. Lessig may be suggesting that the law should prevent companies from tipping the market in the first place.

A fundamental assumption of the antitrust laws is that the challenged behavior must actually occur. Generally, the possibility that a company *could* exploit a monopoly position is not actionable.<sup>2</sup> Monopolies gained by virtue of business acumen are not illegal, after all. The reason behind this policy is that the incentives to create the monopoly in the first place are meaningful. The drive to make the most profit spurs innovation to a greater and more efficient extent than other incentives. By ignoring antitrust and substituting a top-down solution, Lessig asserts the profit motive is insufficient to protect the Internet and perhaps ideas themselves. Antitrust can contain anticompetitive behavior in cyberspace. But the behavior it should contain is not hypothetical bottlenecks but bottlenecks that are actually exploited. Anything less creates a regulatory bureaucracy where the government effectively decides which innovations succeed.

*The Internet of the last*

*decade fostered a*

*nonrivalrous creative*

*commons.*

### **The Future of Ideas**

To Lessig, the Internet of the last decade fostered a nonrivalrous creative commons—a place where individuals were free to share ideas, to innovate and to create, where the apparatus of creativity was free to anyone to use, and where use by one did not constrain use by another. Lessig believes that today's Internet is becoming a private space. Commercial interests are imposing new technological and legal bottlenecks to gain control over the Internet's infrastructure and the content flowing over that infrastructure. Companies like Comcast control the physical wires through which data is transmitted (the "pipes") and can decide what goes over those pipes. Companies like Cisco are creating functionality that can discriminate in the types of information that are distributed over the Internet and can determine what information gets through. Companies like Microsoft control the human interface and can decide what people see. Companies like Disney control the content and can decide which ideas gain exposure. And, through what Lessig sees as the unwarranted expansion and enforcement of intellectual property rights, companies are beginning to control the very mechanism of creativity. By preventing people from building upon the expressions of ideas, companies are restricting the process of innovation.

The result is that commerce, entrenched and inefficient, will control what ideas are shared, what innovations succeed, and what is created. To Lessig, this battle is between old and new—between the entrenched trying to preserve control and the challengers trying to dislodge that control with disruptive technology and ideas. Society is losing.

His solution is a re-imposition of the commons—freed spectrum, state-sponsored construction of cable pathways, neutral code platforms, and, most controversially, amending the intellectual property laws to include limitations on the terms of copyrights and patents and a moratorium on new Internet and software patents until the government has assessed their effect on innovation.

---

<sup>2</sup> There are exceptions. Section 7 of the Clayton Act is basically forward-looking at least in application. Although attempted monopolization under Section 2 of the Sherman Act is also forward-looking, it requires a dangerous probability of success—something more than just a guess that a corporation might obtain monopoly power.

## Lessig's Layers

Lessig conceptualizes the Internet in terms of layers—physical, code, and content. Roughly, the physical layer is the hardware. The code layer is the software. The content is what is shared. By dissecting the structure of the Internet and articulating where possible bottlenecks can be asserted, Lessig lays out the framework of modern antitrust analysis.

***The Physical and Code Layers: Antitrust in the Information Age.*** The physical layer consists of the physical infrastructure. Servers, computers, broadband cable, the telephone lines, and spectrum. For the most part, Lessig believes that companies that invest in creating the infrastructure should be able to profit from that investment.<sup>3</sup> He does not believe, however, that they should be able to leverage that power. Lessig offers the example of recent improvements Cisco is considering to their routers. A router is a device that physically moves or “routes” digital information over the Internet. Cisco makes most routers. In the past, there was no way of distinguishing one piece of information from another on the Internet. Now, Cisco is developing a technology that can distinguish types of information so that “favored” content will be allowed to flow more efficiently than disfavored.<sup>4</sup> Conceivably, Cisco could use the power over that evaluation process to leverage control in other areas.

The code layer involves the software that organizes and moves content over the Internet's physical layer. If Microsoft were to gain control over the browser market, it could then gain control over the interface by which individuals can access the Internet. By controlling the interface, Microsoft would also be able to control the content. Moreover, because Microsoft could keep the browser proprietary, individuals would not be able to use the browser's code and so could not improve or expand on it. An important means of innovation would be stifled.

Lessig's solution is “open code” and “open access.” Open code prevents entities from using the code strategically. Moreover, open code also enables users to defeat any attempt to bottleneck by giving them a means to work around the bottleneck. Innovation would be further spurred, he feels, by the “promise” that no one would be able to shut down innovation through the use of protected intellectual property. In addition to requiring open code, Lessig also believes that the government should limit the ability of private entities to redesign the Internet along proprietary lines. He suggests legislation similar to the Telecommunications Act of 1996.

In many respects, Lessig's stories about Cisco's control over what information is routed, about the cable companies' control over the wires, and Microsoft's control over the user interface are admonitions calling for a more forward-looking response from antitrust. But Lessig does not offer antitrust as a response. Conceivably, antitrust is not viable because it waits until companies with bottleneck power actually use that bottleneck power to harm competition. Thus, antitrust cannot prevent the monopolist from becoming entrenched, and innovation is squelched.

One theme to come out of the Internet boom was that many in the bricks-and-mortar world “just don't get it.” To many, “not getting it” meant lacking the vision to see what the technology could do, how it could transform commerce and society, and how these accomplishments could all be realized in the shortest intervals. To some, this view suggested that a new way of applying the antitrust laws was required. The application of antitrust—if it was to be applied at all—had to be more forward-looking. One had to look at the technology, anticipate how it might be used, and then use the antitrust laws to prevent anticompetitive manipulation.

*Open source and*

*open access will*

*restore the creative*

*commons.*

<sup>3</sup> *Id.* at 241.

<sup>4</sup> *Id.* at 156.

Lessig proposes government regulated open source and open access as a viable response. One could view this proposal as suggesting that the innovation inspired by open source and open access is superior to the innovation inspired by free enterprise. Essentially, an academically-oriented incentive system is better than a commercially-oriented one. In an academic setting, the innovator's incentive is to achieve ubiquity—to maximize his name recognition and reputation. As a result, people share ideas, develop new applications, and correct bugged code freely because with each new idea, application or fix, their name and reputation are enhanced. Open source and open access maximize the individual's potential in this setting because openness eliminates the restriction on the individual's ability to build on previous work. In a commercial setting, the innovator's incentive is profit. To maximize profit, the innovator will try to create bottlenecks he can exploit. These bottlenecks limit the individual's potential because they impose restrictions on the individual's ability to build on previous work. These bottlenecks also stifle the development of disruptive technologies. By controlling the bottleneck, a monopolist can limit the ability of disruptive technologies to dislodge the monopolist. The monopolist can, for example, create incompatibilities that dramatically increase switching costs and so prevent the disruptive technology from gaining a sufficient customer base to flourish. Forced open source and open access eliminate the ability of companies to create bottlenecks and create greater opportunity for disruptive technologies.

Open source and open access, however, reduce the commercial incentive to innovate. If a company cannot achieve a reasonable return on its research and development investment, it will not invest.<sup>5</sup> Open source and open access as solutions to the problem of monopolist suppression of disruptive technology also underestimates the ability of the antitrust laws to prevent it. Greater regulation can create the environment Lessig believes is best, but leaves open the question whether an exclusively academic model is the most efficient. A system that encourages both is better.

Lessig's analysis is the framework of modern antitrust. Analyze the technology. Predict possible bottlenecks. If the bottlenecks actually arise, apply antitrust law as it exists. If the bottleneck was created by virtue of business acumen, the company attaining the bottleneck should be allowed to reap the benefits. If the bottleneck was created by virtue of a series of exclusive dealing contracts, however, it should be challenged under Section 1 and 2 of the Sherman Act. If the bottleneck was created by virtue of leveraging, it should be challenged under Section 2. And if the bottleneck or disruptive-technology-constraining incompatibility is claimed as an "innovation," courts should follow Judge Jackson's rule in *Microsoft*.<sup>6</sup> "Innovation" is no longer "per se procompetitive," but subject to analysis.<sup>7</sup> Antitrust may be slow to move. Indeed, it may even be slow to articulate the behavior that is offensive.<sup>8</sup> This lack of speed may have some benefits, though. It lim-

---

<sup>5</sup> Lessig's story about the success of Linux probably misinterprets the reasons why companies like IBM are supporting it. IBM may very well be inspired to develop Linux out of a desire to get out from under the control of a heavy-handed monopolist rather than a fundamental belief in the open source movement.

<sup>6</sup> *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000), *aff'd in part and rev'd in part on other grounds*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001).

<sup>7</sup> If a company controls an essential facility and manipulates it to the detriment of competition, the courts should open that essential facility to common usage. One should not, however, second guess whether a possible technology could become an essential facility. That second guessing—far from reflecting the fact that we "get it"—might actually cause more harm to innovation than it prevents.

<sup>8</sup> Raising rivals' costs is one example. Rockefeller's rail transport conspiracy was affected almost a century ago. Rockefeller, in effect, created a technological bottleneck. By getting the rail transport providers to charge higher prices to his rivals' than those charged to him, Rockefeller

its the ability of others (including the government) to change behavior that may actually be efficiency enhancing. And in the high technology environment, the lack of speed may prompt others to work around potential bottlenecks as a solution to the slow pace of investigation and litigation further fostering innovation.

***The Content Layer: Copyrights, Patents, and Ideas.*** The content layer consists of what is sent over the Internet. The principal issue with regard to the content layer is the ever-increasing control the courts and government are giving intellectual property rights holders.

***Copyrights.*** Originally, the copyright laws offered a “porous protection.” In order to spur innovation, the government would grant a limited right to people to protect their expressions from copying.<sup>9</sup> Eventually, the material would become part of the public domain. Once in the public domain, “second comers” would have the opportunity to do something with the work, perhaps even make more of it.<sup>10</sup> The Copyright Act originally applied to “maps, charts and books.” Copyrights attached after they had been published and registered. Derivative works were not covered. Now, as soon as a work is reduced to a tangible medium, it is protected by copyright. No registration is necessary. Copyrights used to be limited to fourteen years, renewable once if the owner was alive. Now copyrights last for the life of the author and seventy years. Congress has extended the copyright term several times in the last few years.

To Lessig, this expansion of copyright protection unjustifiably extends “monopoly” protection. Monopoly protection should only be granted when “justified.” Lessig does not feel that “every copyright must prove its value up front” because that would be too cumbersome.<sup>11</sup> He does feel, however, that “every system of copyright or patent should prove its value up front. Before the monopoly should be permitted, there should be reason to believe it will do some good—for society, and not just for monopoly holders.”<sup>12</sup> Presumably, he means that before allowing business method or software patents as a matter of policy, someone should evaluate whether it would be a good thing to do so. Perhaps through a comment period similar to the one required under the Tunney Act.

Lessig believes that people should register their copyrights. He also believes that copyright protection should last for an initial period of five years, renewable fifteen times. After that period, the copyrighted work would fall into the public domain. For private, unpublished correspondence, the current regime would suffice. Software copyrights should be treated differently, however. One of the most significant reasons for treating software differently is that the copyrighted material is not disclosed. Software is compiled—it is converted into 1’s and 0’s that only machines can read. Because no one can read the copyrighted material, no one can derive benefit. The original exchange—the right to exclude for the right to see—fails. Lessig’s solution would be to grant protection for five years with one renewal. After the copyright has expired, society would get access to the source code. Protection would be granted only if the author submitted a copy of the code to be held in escrow.<sup>13</sup>

---

was able to convert the rail system into a bottleneck that he was able to exploit to drive his rivals out of business. Although successfully challenged at the time, only recently have economists described the behavior. See Elizabeth Granite, *Monopolization by “Raising Rival’s Costs”*: *The Standard Oil Case*, 39 J.L. & Econ. 1 (1996).

<sup>9</sup> *Future of Ideas*, at 249.

<sup>10</sup> *Id.* at 106 (citing remarks by Learned Hand).

<sup>11</sup> *Id.* at 250.

<sup>12</sup> *Id.*

<sup>13</sup> Lessig also addresses the issue of software that protects copyrighted material from being copied. If companies can protect their works with both the law and protection packages, the protection they receive from the law should be limited. He thinks that Congress should require

*Patents.* For Lessig, patents are more problematic. Since *State Street Bank*,<sup>14</sup> the United States Patent and Trademark Office has issued many potentially innovation-dampening patents. They include Amazon.com's 1-click patent, Priceline.com's patent on reverse auctions, and British Telecom's patent on "hypertext links." Lessig feels that some of these Internet business method patents and software patents do little social good. They afford companies protection without offering any increase in general innovation. Lessig believes that the government should study business method and software patents, and, if it cannot be demonstrated that these "forms of innovation regulation" are "more likely to aid innovation than harm it," then Congress should withdraw protection.<sup>15</sup> Lessig believes Congress should enact a moratorium on "the offensive use of these questionable patents" until the study is complete. If Congress does determine that Internet and software patents do have value, Lessig believes that they should be limited in duration—less than five years.<sup>16</sup>

Lessig may be correct in his critique of the patent system. Certainly whether and to what extent patents spur or inhibit innovation and the variety of ways they can be manipulated need to be studied. The Federal Trade Commission and Department of Justice are currently holding hearings on the issue. It is not clear, however, that the solutions Lessig offers with regard to the registration of copyrights and limited terms for business method and software patents are necessarily the best next step. Among other things, adoption of Lessig's suggestions would require abandoning several significant treaties that harmonize intellectual property laws. While Lessig refers to these treaties in a footnote, he does not assess the harm a de-harmonization of the laws would have on the economy and innovation internationally. Other possible solutions include a relaxation of the obviousness standards including statutorily limiting the ability of courts to rely on "commercial success."<sup>17</sup> Another solution would be to increase funding to the Patent and Trademark Office so that it could hire more experienced examiners. Of the two, relaxation of the standards for obviousness carries the greater risk in that it could cause a material contraction in the number of patents issued thereby discouraging people from investing in research and development. More funding stands a greater chance of success although it may prove difficult in tight years.

Lessig's suggestion that those who seek software or Internet business method patents (or software copyrights) should be required to disclose their source code is worth pursuing. Under this approach, if a company wants the right to exclude others, that company should disclose not only its idea conceptually but the actual means by which the idea was accomplished. Not only would this foster Lessig's follow-on innovation, but it would also restrict a company's ability to create and exploit bottlenecks. To the extent a coder wished to keep his innovations secret, he would have to rely on trade secrets protection. Piracy would, of course, be an even bigger issue. But the coder would make the choice.

*Ideas.* Perhaps most interesting is Lessig's notion that aggressive copyright enforcement could limit creativity to the point where the "future of ideas" was at risk. Lessig opens his book with a few vignettes about copyright and film making:

---

that any law that affords protection to copyright protection systems should be limited by the reach of the copyright law. Only systems that allow fair use are themselves afforded protection. Lessig mentions the various conventions and treaties that brought about these changes in our laws, but does not discuss the effect that repudiation of these treaties might have.

<sup>14</sup> *State Street Bank & Trust Co. v. Signature Fin. Group*, 149 F.3d 1368 (Fed. Cir. 1998).

<sup>15</sup> *Future of Ideas*, at 259.

<sup>16</sup> *Id.* at 261.

<sup>17</sup> Claimed inventions are not patentable if they are obvious. 35 U.S.C. § 103.



The film *Twelve Monkeys* was stopped by a court twenty-eight days after its release because an artist claimed a chair in the movie resembled a sketch of a piece of furniture that he had designed. The movie *Batman Forever* was threatened because the Batmobile drove through an allegedly copyrighted courtyard and the original architect demanded money before the film could be released . . .<sup>18</sup>

Lessig asks rhetorically “[w]hat is the mentality that gets us to this place where highly educated, extremely highly paid lawyers run around negotiating for the rights to have a poster in the background of a film about a frat party?”<sup>19</sup>

As Lessig formulates it, it does sound absurd. And to some extent, Lessig is right that these restrictions do impede the ability of artists to create their vision. But there have always been restrictions. In any event, copyrights don’t limit a second comer from using the idea—merely the expression of the idea. If the idea is free to the second comer, it is difficult to imagine how creativity or innovation could be harmed in the main.

### Conclusion

Lessig is right to question business’ motives in developing technology. He is also right to challenge the current intellectual property system. Both need to be examined. He underestimates the value of antitrust and the free market, however, in preventing monopolization and advancing innovation. He certainly doesn’t consider the effects his proposed changes in copyright law might have on a more globalized economy. His vision of a restored creative commons is poetic, but may limit innovation more than he anticipates. And the conclusion that the future of ideas is at risk simply cannot be right. But maybe that wasn’t his point.

In a recent letter to the editor of the *Washington Post*, Jack Valenti, the chairman and chief executive officer of the Motion Picture Association of America, responded to a letter from Professor Lessig suggesting that the film industry’s inability to license their films for Internet distribution are stifling innovation in the digital world.<sup>20</sup> Valenti claims, among other things, that the “movie picture industry is under siege by a small community of professors . . .” Clearly, someone is reading Professor Lessig’s work, and it is fostering discussion. Even though the work was printed in a newspaper. Much like his copyrighted book. ●

---

<sup>18</sup> *Id.* at 4.

<sup>19</sup> *Id.*

<sup>20</sup> Jack Valenti, *Movies Get Framed*, WASHINGTON POST, Feb. 25, 2002, at A 23.

# Interview with Michael Katz, U.S. DOJ's Chief Antitrust Economist

## ABA Section of Antitrust Law "Brown Bag Program"

December 5, 2001



**Michael Katz**

### S P E A K E R

#### **Michael Katz**

*Deputy Assistant Attorney General  
for Economic Analysis  
U.S. Department of Justice  
Antitrust Division*

### M O D E R A T O R

#### **Henry McFarland**

*Vice Chair  
ABA Section of Antitrust Law  
Communications Industry  
Committee*

### Q U E S T I O N E R S

#### **Philip Nelson**

*Chair  
ABA Section of Antitrust Law  
Economics Committee*

#### **Barry Nigro**

*Chair  
ABA Section of Antitrust Law  
Communications Industry  
Committee*

**Ed. Note:** Michael Katz, Deputy Assistant Attorney General for Economic Analysis at the U.S. Department of Justice, offers his views with notable thoughtfulness and clarity in this discussion of antitrust and economics in the new Administration's Antitrust Division. As Chief Economist of the Division, he directs a staff of approximately fifty economists and oversees the analysis of economic issues arising in both merger and non-merger enforcement.

On detail from the University of California at Berkeley since September 1 of last year, Dr. Katz is the Edward J. and Mollie Arnold Professor of Business Administration at the University of California at Berkeley, where he also holds an appointment as professor in the Department of Economics. He is a four-time finalist for the Earl F. Cheit award for outstanding teaching and has won it twice.

The interview draws on Dr. Katz's experience in antitrust as well as in telecommunications. He served as Chief Economist of the Federal Communications Commission from January 1994 through January 1996, where he participated in the formulation and analysis of policies toward all industries under Commission jurisdiction, including broadcasting, cable, telephone, and wireless communications.

Dr. Katz has published numerous articles on the economics of networks industries, intellectual property licensing, telecommunications policy, and cooperative research and development. He has served as co-editor of *The California Management Review* and a member of the editorial board of *The Journal of Economics and Management Strategy*. Dr. Katz also served on the *Computer Science and Telecommunications Board of the National Academy of Sciences* and was the Director of Berkeley's Center for Telecommunications and Digital Convergence.

Dr. Katz holds an A.B. summa cum laude from Harvard University and a D. Phil. from Oxford University. Both degrees are in economics.

*The following interview was conducted as a joint “Brown Bag” program of the ABA Section of Antitrust Law Communications Industry and Economics Committees. The session was moderated by Henry McFarland, Vice President, Economists, Inc., Washington, DC. Questioners were Barry Nigro, a Partner in Fried Frank Harris Shriver and Jacobson in Washington, DC, and Philip Nelson, a Principal with Economists, Inc., in Washington. As is customary with the Brown Bag interviews, the audience, participating in person or by teleconference, also was able to question the speaker.*

*The Brown Bag session took place on December 5, 2001. The Antitrust Source is pleased to present this edited and updated version of the transcript of that session. We also provide in this interview Dr. Katz’s answers to additional questions posed to him by members of our Editorial Board on February 25, 2002.*

---

**HENRY MCFARLAND:** Today’s Brown Bag, which is being jointly sponsored by the ABA Section of Antitrust Law Economics and Communications Industry Committees. Our speaker today is Michael Katz, the Deputy Assistant Attorney General for Economic Analysis. In addition to questions from the audience, he will be questioned by Philip Nelson, Chair of the Economics Committee and Barry Nigro, Chair of the Communications Industry Committee.

Dr. Michael Katz is the Deputy Assistant Attorney General for Economic Analysis in the Antitrust Division and the Former Chief Economist of the Federal Communications Commission. Following his brief introductory remarks, he will answer questions both from the audience here and from the audience at the different satellite locations. Philip Nelson and Barry Nigro will interject questions where they think it is appropriate.

**MICHAEL KATZ:** I’d like to mention a couple of things before I get started.

One, I want to be clear that I’m going to talk about *my* views on matters. You can try and read into my remarks what it all means for the Department of Justice, but I’m not going to say, “This is what the Department’s going to do.” You should view these remarks as my thoughts on economics and anything else I talk about.

Second, I want to say a few things about the economics of mergers. I won’t say anything in my opening remarks about telecom specifically. However, you should feel free to ask me questions about telecom.

Let me say a few things, generally, about mergers and, in particular, about unilateral effects and merger policy. The major thing we’re supposed to be looking at is competitive effects. Being an economist, I, of course, view this as an economics exercise, where you need lawyers to help you get the papers filed. Unfortunately, my colleagues at DOJ don’t all see it that way. In any event, let me say a little bit about the economics of merger analysis. I might as well just jump in with a couple of remarks about the theories of harm.

There’s at least a perception among practitioners that there’s a problem with unilateral effects theories. Sometimes the question I get is whether there are too many unilateral effects cases. Sometimes it’s whether there are not enough coordinated effects cases. I suspect that, in fact, there is unhappiness with particular merger cases in differentiated products consumer goods markets, and that’s what people mean when they say they don’t like unilateral effects cases.

I keep hearing there are too many unilateral effects cases or the agencies run amok with the theory, but nobody has ever mentioned to me which cases they are talking about. Certainly, from my distant view in California, as I look over the past few years, most of the complaints I’ve heard are

*I generally think that there's been an uneven development in the antitrust economics of unilateral effects theory and coordinated effects theories, and I think it would be useful to redress that balance.*

from people saying, "There are too many mergers going through and why don't the antitrust authorities block them?" I have not heard the view that there are too many being challenged. So at some point, either today or in the future, I would like to hear what people have in mind when they talk about the problem.

That said, I think there are issues to talk about. I generally think that there's been an uneven development in the antitrust economics of unilateral effects theory and coordinated effects theories, and I think it would be useful to redress that balance. So I want to talk about that a bit.

Before I do that, though, I also want to say one thing that is probably heresy in general, and is certainly heresy among economists. I don't think we have a good sense of what we mean when we say "unilateral effects" and unilateral effects cases. I know some economists would mean taking the differentiated-products Bertrand model of the industry and seeing what it says. Now, you can conduct that exercise, and it can be a useful exercise and a way to stimulate your thinking, but I can't believe that's what we mean by our theory of harm because, typically, that model is at best an abstract representation of how an industry works that we use to get general insights. Another definition of unilateral effects given by many is that, post merger, the parties can raise their prices even if nobody else goes along. Of course, as soon as you say nobody else goes along, you've got to tell me what that means. Does that mean rivals freeze their prices? Freeze their investments? Freeze their products? Freeze their output? Well, they can't do all of that because it may be impossible to freeze both output and prices, unless firms just turn customers away. I think by definition there has to be some reaction of competitors to anything a firm does. So, if you're going to say that unilateral effects occur when a firm acts, but none of its rivals does anything, that's essentially a vacuous statement. You have to have in mind some notion of an accommodating or non-accommodating response, and I don't think that has been very well thought out in unilateral effects, beyond where you take the differentiated products, one-shot game, or Bertrand model. I think that this model has got to be narrower than what lawyers have in mind when they talk about unilateral effects. I think that if we're going to get into this debate much, we need to go back and rethink exactly what we mean by these terms. As I said, I may be a minority of one in thinking that, but I issued a disclaimer at the beginning of my remarks.

That said, let me pretend we all know what unilateral effects and coordinated effects are, and just say a few things about each because there is a certain aspect of this exercise that invokes the old saying about how to define art or pornography: you know it when you see it. From the unilateral effects standpoint, there is this sense that there are too many unilateral effects cases or somehow the theory has run amok. In a lot of ways, it's ironic because if you think about why we saw a rise in unilateral effects theories relative to coordinated effects theories, it was because there was a concern that coordinated effects theories lent themselves to mischief.

The historical approach to coordinated effects analysis has been to check for the presence of a set of structural factors thought to be conducive to tacit coordination. For example, are prices publicly posted, as in a supermarket, or are they privately negotiated, as in the sale of aircraft engines? Publicly posted, uniform prices are generally thought to make coordination easier than are negotiated prices that vary across customers and are not made public. People debate whether product differentiation makes tacit collusion harder or easier. Another example of a factor is whether firms have the same cost structure.

There are several problems with this approach. One is that we need a better understanding of the theory and empirical support for the various factors. Two, we need to understand how these factors matter for assessing the impacts of a *change* in market structure. Three, we need a way to assess the combined effects of the various factors. If one simply weighs them up in some myste-

rious way, then one can get out of the process whatever one wants, because in almost any industry one can find some factors that suggest the ability to sustain tacit coordination would be made worse by the merger, but those same industries would have other factors pointing in the opposite direction.

There was a concern that this approach would lead to too little discipline in terms of bringing cases or doing analysis, that there were just too many degrees of freedom or too much flexibility. A big part of the thinking behind the rise of unilateral effects theories was that we can pursue them more rigorously; we can tie them into econometrics; we can quantify the factors and balance them; all to put the whole analysis on much more sound footing and stop people from bringing cases that aren't warranted.

Now, it's certainly my sense that a lot of people in the antitrust bar do not think that's how it has turned out. To the extent that there's an actual or perceived problem with unilateral effects theories, part of the problem is that the Division should, and I think will, be clearer about the materiality standards it uses. You hear people say that if you use a unilateral effects model, then in almost any differentiated product merger you're going to find some effects, and there are people who say that can't possibly be right, so the theory must be wrong. I would offer a different view of the issue. Barring efficiencies, it may well be true that, when one analyzes a large number of differentiated product mergers, one's best estimate is that there will be some increase in price. But that doesn't mean we should bring a case because, of course, there's always uncertainty in these things, and there are going to be other effects brought about by the merger, such as reactions by other firms. There are efficiency claims. So I think we need to be clearer about what is done. It's not the case that we will oppose a proposed merger simply because some model predicts that prices will go up one-tenth of 1 percent while other iterations may say something different. Our decisions are based on the overall analysis, which may include econometrics, but certainly not econometrics alone. We will also be looking at the facts of the case and sometimes directly making sure we have a story that makes sense, that fits with the way people in the industry think about the market. We have to decide when the effects are big enough, given the other things going on in the case, like the efficiencies, and also take into account that if we don't know what we're doing, we should leave the market alone. We need to be clear about how we make these determinations.

Let me give one example where it seems that people really wonder what's going on with unilateral effects. Some people have said we should never bring a unilateral effects case because all we're doing is admitting we couldn't get the relevant product market to work and that we lost the case on the question of relevant product market. Not necessarily that we lost in court, but that we lost intellectually when we were trying to factor the relevant market in our analysis. The claim is that we'll make an end run around our burden by saying that the market is really broad, but then claiming there are narrower unilateral effects within the broad market.

If you think that we approach market definition and prosecutorial discretion in the ways I am about to describe, then it is understandable that you would think this of us. Consider the following hypothetical. Suppose the way one defines a relevant product market is by determining whether a hypothetical monopolist could impose a small but significant non-transitory price increase of 5 percent or more, and do it profitably. Suppose that the number for materiality was 5 percent, which is to say that one wouldn't bring a case unless the best projection of what the merger would do is to raise prices by at least 5 percent. In this hypothetical world, the only kind of unilateral effects cases one would see are those arising from mergers of two firms to one. This view of materiality says that if these two firms were to merge, then controlling the products they jointly control, they'd be able to raise the prices by 5 percent; that's the materiality standard. Now, if you go back to the

market definition process that I posited for this hypothetical, which looks at the set of products for which a monopoly controlling all of those products could profitably raise prices by 5 percent, then those two firms could do it on their own. So with that materiality standard, if you thought there were unilateral effects, you would think it's a merger-to-monopoly. Who cares whether you call it a unilateral theory or coordinated effects merger-to-monopoly; you wouldn't bother with that distinction.

Now don't rush out and say that we have a chief economist who, even though he doesn't count for anything, admits the DOJ screws everything up, because I don't think those are our standards for market delineation and materiality. What I'm saying is that I would like to see us clearly articulate what the standards are because I don't think the considerations for the two are the same or that the percentage standards are the same. Moreover, I don't think, at least as a matter of economics, that one wants to have a single number for materiality. A lot of it would have to do with the specifics of the market and with our ability to predict the competitive effect with any competence. In some markets, if you thought prices were to go up by 2 or 3 percent, then you might think that's a really big deal. There may be other markets where prices are routinely moving by 10 or 20 percent in a year and those aren't really the important dimensions of competition—you need to worry much more about innovation or something like that. So I think part of the debate about unilateral effects really isn't about unilateral effects. It's the question of materiality.

*we are not going to be bringing cases where the sole reason for being concerned is that a simulation model says a merger is going to have a bad effect.*

Another part of this debate that is somewhat misdirected is a concern that somehow economists have run amok, that they've gotten a bunch of computer models and they're simulating mergers with abandon. Some of you appear to be assuming you and your clients will all be victims of software gone awry or an economist gone awry with the aid of software. Again, that's a misperception and overreaction. I can certainly say going forward—and you may be able to point out examples from the past, although I don't know of any—that we are not going to be bringing cases where the sole reason for being concerned is that a simulation model says a merger is going to have a bad effect. We will be looking for a story and want to look at the actual institutions and structure of the market, understand how it works, understand how market participants think it works, and be able to tell that story and work through it. I think simulations have a useful role to play, but, as others have said, we are still in our infancy in learning how simulations work and in learning what they tell us. That said, I don't want us to stop doing simulations. They can be useful and they can provide information, so we'll keep doing them.

Another thing I want to do is make a distinction between simulation and estimation, where the latter is the process of calculating past competitive effects using econometrics. Sometimes, we have an industry that has multiple markets within that industry and they have different firm organizations or different concentrations, for example, across the different markets. In these circumstances, doing a cross-sectional study can be a very useful way of understanding whether, for instance, we should be worried about a merger based on whether concentration appears to matter. Some people say, "Oh, it's just econometrics; you're just making this stuff up." That criticism could be valid with bad simulations. I guess it could be true with any bad econometrics. But particularly when you're doing these cross-sectional studies, the criticism is exactly backwards; those studies are about trying to understand the facts of the market in a systematic way to see if there really are effects. In fact, that's a very good discipline in conducting the analysis of a merger. In discussing the role of econometrics, I don't think it makes sense to lump simulations and these cross-sectional or historical studies together. Now, obviously, they are sometimes used together. For instance, you do estimation to get the parameters for the simulation model. But they are two different exercises, and each of them certainly has its room for improvement.



There are things the Division is doing in cooperation with the Federal Trade Commission. You've probably heard about some of them. We are working together on the econometrics of unilateral effects. We're working to improve techniques in cooperation with each other, and that effort will involve cooperating with the private bar and with industry, as well. So let me add just a couple of things about coordinated effects; that is another area where we're working internally with the Federal Trade Commission to improve our thinking in order to bring as much discipline and rigor to that as we can.

It is a fair assessment that development of economic tools for unilateral effects has gotten out ahead of where we are with coordinated effects. If you think about how we talk about coordinated effects, the typical sorts of principles, tools, and techniques that we put out are probably the same as those put out ten or fifteen years ago. Partly, that may speak to the principles' being good ones and to identifying the right effects, but there is room for developing additional investigative tools. One of the things we have to do, instead of looking at factors individually, which is often how they're talked about, is to start thinking about clusters of factors and any particular patterns we tend to see.

We need to do everything we can to understand the interactions among different factors. An important point is to go beyond simply stating factors in isolation and then somehow counting them up. We do go beyond this, but I just want to remind ourselves that we need to do even more. The factors provide an indication of whether an industry is one in which tacit collusion is likely to be successful or less likely to be successful. We need to tie our analysis as much as we can to how a merger would *change* those factors and the likelihood of tacit collusion. We see this type of analysis when people ask whether one of the merging parties has been a maverick, because then you're very much saying this merger is going to cause changes that really matter.

It can be dangerous criticizing the agencies from the outside, but before I got to the Division, the focus may have been too much on whether different industries were conducive or not to collusion, without asking enough about whether the merger actually changed things in a way that mattered. Now, certainly since I've been at the Division that's never happened. But, as an outsider in the past, it looked like that. Those are just some of the things to do to build up our ability to analyze coordinated effects to the extent that we have with unilateral effects.

I'd like to stop there and now briefly talk about the role of economists and whether economists should run the world. I will say only a couple of things on the role of economists. First, if you bring your economic experts to the Division, let them talk, please. It's something of a mystery to me why people hire expert economists and don't let them talk. One question related to the merger review process initiative that Charles James has announced [Ed. Note: See <http://www.usdoj.gov/atr/public/9300.htm>] and that the Division has been publicizing is, where do economists fit in? We are making an effort, and we have made this effort in the past, even before this initiative, to have our economists talk to your economists. One recent matter had the economists talking to each other without a legal chaperone, and we would like to do more of that.

You may have two sources of frustration in dealing with us, and we are working to fix them. Well, we may not be fixing one of them because it is beyond our control. That source of frustration arises when our economists talk to yours and you want to see our data. The problem is that "our data" often are not our data; they are somebody else's proprietary data that we've obtained. That has been a stumbling block: we'll have data and we can't share them; we're not legally authorized to do that. I recognize that's a source of frustration to you. It's something we're thinking about. It's something you'll run into, but you should not take it as though we're trying to hide the ball. We are willing to explain what we're trying to do in an investigation, and we have gotten, in some recent matters, good feedback from outside economists suggesting alternative ways for us to conduct our analysis.

Then we will go back and try those things with our data and do what we can.

The second source of frustration is that sometimes we do not have as much give-and-take as people would like because we are under so much time pressure. Sometimes I'd like to go talk to the outside economists, but I've also got to do my job, which is to get the investigation done. If I don't get this stuff done, we're in trouble. On that, I will make a plea, which may fall on deaf ears, for you not to pursue the strategy of giving us time to analyze the merger in dribs and drabs, because it wreaks havoc on our ability to conduct systematic economic analysis. If we're being told that we might have to be done in a week, then why bother getting a comprehensive data set? Why bother doing careful analysis? I don't think that works in anyone's interest. I understand why there's a legal strategy behind trying to do that to us and to string us along, but I think in terms of having us do good analysis, you would be better off, and we would be better off, if we both agreed to say, "Here's the plan, here's how much time you'll have," up front. That would give us more ability to work with your economists, if you have them, and to listen to you and take your analysis into account. I haven't been here very long, but in my brief time here, I have seen evidence that we do, in fact, listen. What outside economists have said has affected the way we've analyzed mergers. So, I think it's been an improvement all around.

**AUDIENCE QUESTION:** You talked about unilateral effects cases and suggested that they could often be viewed as two-to-one mergers. My understanding is that some unilateral effects theories involve the following type of situation: a large firm acquires a smaller firm that produces a differentiated product that is a relatively close substitute, but is only purchased by a small percentage of the market. The concern is that after the merger, the merged firm may raise the price charged for the product supplied by the smaller firm, while not changing the price charged for the product supplied by the larger firm. This price increase is profitable after the merger because many of the customers that stop buying the small firm's product start buying the large firm's product and, thus, are not lost to the merged firm. Before the merger, a price increase is not profitable because all of the customers that would stop buying the small firm's product would be lost to unaffiliated firms. After the merger, the price increase is profitable because many of the customers that stop buying the small firm's product are diverted to the acquiring firm's product. In this situation, would you consider this to be a two-to-one merger and, if not, would you still be concerned that the post-merger price increase might be material?

**KATZ:** Well, I think it certainly comes back to what your materiality standard is. Before discussing the treatment of price changes for limited product sets, I want to reiterate my earlier position on unilateral effects and market delineation. The hypothetical I was giving you, in which finding a unilateral effect would imply that the merger was two to one, was a hypothetical in which the materiality standard was such that all the prices had to be raised by 5 percent or more. In my view, that's an unrealistic hypothetical. I was offering it as a possible explanation of incorrect views that some people have about the Division enforcement actions.

I don't think we should have a flat percentage as a materiality standard in any case because I think you have to account for variations across markets. Moreover, I think it's also incorrect to say that the materiality standard should be that all the prices in the market must go up by the same percentage. It's clear, if you look at markets in any detail, that in a lot of markets, the ability to raise prices will vary by customer classes or customer type and, particularly in industrial markets, an awful lot of the prices are negotiated specifically with customers. So as we think through materiality, we're going to have to deal with the issue of whether it is across the board or not. So we have to deal with

whether some products and not others are affected, and the short answer is there are surely going to be cases where, yes, some products would go up in price and others wouldn't, and that would be enough for us to be concerned and to challenge a merger. It would depend on the amount of the commerce affected.

**ANTITRUST SOURCE:** You discuss some vague considerations relating to the materiality of the price increase, but you also suggest in response to a question about a merger between a very large and very small firm that the amount of commerce affected is also relevant. Have you considered any factors that might be relevant in deciding when the amount of commerce becomes "significant?" For example, one could look at the post-merger share-weighted average price increase. If that were very small (say, under 1 percent), but the acquired firm's price increase is predicted to be 10 percent, would/should the Division take action against this merger?

**KATZ:** Intervention could be appropriate for some circumstances fitting the fact pattern you describe. I don't think it is appropriate to focus solely on the *average* percentage price change. If one takes changes in consumer surplus as the appropriate welfare measure, then the competitive effect is approximately the percentage change in price times revenue for each separately priced product. Suppose that, absent any efficiencies, there are significant competitive harms associated with one segment, and no effects in others. It does not matter how big the unaffected segments are relative to the affected segment; there is a problem worth investigating further. Of course, before opposing the merger, one would want to take efficiencies into account to determine the net effects on consumers. This might involve balancing gains in some segments against losses in others. (I will sidestep the legal issue of whether one can make such tradeoffs.) In addition, one might want to consider litigation costs as a matter of prosecutorial discretion. Under a total surplus standard, the welfare effects would be measured differently but the principles would be the same.

**PHILIP NELSON:** Has DOJ adopted any standards that attempt to define "material effect" more clearly? At an ABA session that was held around the time the first joint DOJ-FTC Merger Guidelines were announced, I asked John Peterman, who was then head of the FTC's Bureau of Economics, whether a merger that was likely to lead to a 1 percent price increase raised sufficient antitrust problems that the FTC might intervene. John responded that he understood that the lawyers at the FTC, if they were sure that there would be a 1 percent price increase, would be worried about the merger, even though they were using 5 percent standard in their efforts to define relevant markets. Given this background, do you know whether today a 1 percent price increase would be viewed as material under the DOJ's interpretation of the Merger Guidelines?

**KATZ:** The Division clearly does have materiality standards. However, some of the concern about the DOJ's analysis of mergers using a unilateral effects approach is that we haven't done a good enough job communicating what these materiality standards are. Part of the difficulty in the communication is, again, that you really have to look at the specifics of the market. If you ask me if I could write down a hypothetical where a 1 percent increase would concern me, my guess is that I could write down such a hypothetical. Now, if you ask me whether I think I could write down a hypothetical that there was a significant chance I would see in my lifetime where 1 percent would concern me, that's a really different question.

**NELSON:** Some people, including some people at DOJ during the early years of the Merger

Guidelines, have taken the position that the small but significant increase in price that is used to define markets might be different for different markets. Specifically, I recall a speech by somebody within the Justice Department that indicated that it might be appropriate to use a 1 percent hypothetical price increase to define relevant markets in some industries, rather than the more conventional 5–10 percent price increase. Even today, you get in some of the FTC second requests interrogatories about customer responses to price increases that are less than 5–10 percent. Do you think it is appropriate to use a percentage price increase below 5 percent to define relevant markets?

**KATZ:** I don't know for what purpose the FTC is sending out Second Requests of the type you describe. However, it seems to me that market definition and analysis of competitive effect are two different issues. The way they're done by the agencies or done by the courts, they're two somewhat separate exercises. I mean, economists ask, "Why don't we just get to looking at competitive effects?" Done properly, market definition can be a useful discipline, but it is a different exercise than analyzing competitive effects. Now, in terms of the numbers, it is my understanding, and I'm not making this a commitment, that the Division, typically, for market definition, uses a 5 or 10 percent or higher standard. Certainly, staff has told me that these numbers are more like 15 percent, just thinking about different cases. I'm not aware of any case where we've ever done market definition based on some really small number. If for no other reason than that I suspect we'd have a hard time in court establishing that if it's 1 percent, it's not zero.

**BARRY NIGRO:** What sort of factors are considered in evaluating whether to use a 5 percent test, a 10 percent test or a 15 percent test? For example, do you tend to use one in a particular industry and another in a different industry?

**KATZ:** It may well be that the staff has enough knowledge that there are rules of thumb for different industries, but I can't say what the rules of thumb are. Certainly, it stands to reason that they could be different. If you just look at the price behavior in some industries, the prices are pretty stable over the years and then you talk to buyers who will tell you that 1 and 2 percent price differences are a big deal. There are other industries where price differences of 10 and 20 percent may not be that much or, for that matter, may change in the course of a year. So some of it is just putting it in the context of the industry.

My view, and it's actually the view that's expressed by the Merger Guidelines themselves, is that we've gotten carried away with thinking of the Merger Guidelines as a how-to manual for litigation. If the Merger Guidelines are supposed to be what they say they are, which are guidelines for giving insight into how the agencies will think about or decide whether or not to bring cases, then they are like a home-pregnancy test: you can do it and see what's likely to happen. But that's not the same as fully investigating a specific matter and litigating it. The Guidelines certainly provide a way to think about what's happening and what's likely to happen. They provide a short cut for advising your clients. When we're talking about deals that involve billions of dollars, and where millions of dollars are being spent on closing them, the actual analysis is much more detailed and, obviously, is very much case-specific. Personally, I can't see bringing a case where you told me "If the threshold for market definition is 5 percent, we should bring the case, but if the threshold is 6 percent, we shouldn't." We shouldn't be bringing that case because there's no way you can literally fine-tune things that much. So, I think the right way to proceed, when you actually get to specific matters, is in some sense like doing critical elasticities. You can do it with all of these numerical standards. You say, is there a market boundary that seems reasonably robust? If you tell me you've got very differ-

ent answers for 5 percent versus 6 percent, then the answer is no — that's not robust, and we ought to be worried about bringing a case based on it. One should be worried as a matter of public policy, and we should be concerned because you all would have a good time in court against us, if we had something that sensitive. So, in some ways, I think worrying about these numbers is a mistake in the sense that what you really want to do is look at the specifics of a market and say, "If I look at something and apply a 10 percent range, do I keep getting the same answer?" If the answer is "I don't," then I'd better understand why I don't.

The same thing applies with geographic market definition. My sense is that, at least in some cases which went to trial before I got the Division, too much has been made of the precise boundaries. Is it 100 miles or is it 104 miles? Again, that's the wrong question. Where is it that your view of the geographic market really matters? Let's not find whether the precise boundary is 100 miles or 104. Let's find out if when you say it's 100, you get one answer about competitive effects, but when you say it's 104, you get a different answer—then we had better worry. What's happening in between those values? Which is closer to correct? We ought always to remember that, in the end, what we are worried about are competitive effects and so, if you're not getting a clear answer, we want to ask when does the answer matter? Is there a physical size of the SSNIP that matters because we're going to get a very different answer for our competitive analysis? If the answer is yes, then we're going to have to drill down on that. To circle back, what I said is the Merger Guidelines are a useful way for how to do things "quick and dirty," and they provide a useful overall framework for thinking, even when you get into detail. But there's a lot more to do when you start drilling down on a specific case.

**NIGRO:** Maybe I'm missing something, but for the various standards for materiality, aren't we talking apples and oranges? You use one SSNIP to define the market. Then, after the market has been defined, hypothetically you could look at this merger and determine what anticompetitive effect might occur. There may be a harm associated with the merger and the number may be different than the SSNIP. It may be smaller and you still might want to go after it. So are we talking about two different exercises?

**NELSON:** I agree that we are talking about two different exercises. I was trying to clarify two things. First, I was trying to clarify that after the agency has defined the market, at least at the FTC, the agency may be concerned even if they think the post-merger price increase will be small, such as 1 percent. Second, I was trying to clarify that the agencies don't always use a 5–10 percent SSNIP when defining the relevant market. Even today, within the last year or so, I've seen FTC interrogatories that are assuming SSNIPs that are well below 5 percent. I was wondering if DOJ uses SSNIPs below 5 percent in some of its investigations.

**AUDIENCE QUESTION:** What are your thoughts about vertical mergers?

**NIGRO:** In answering the question from the audience, could you answer that question both generally and with respect to the telecom industry, because I know you just spent time with the FCC and you thought about these issues in the context of that particular industry?

**KATZ:** I will give you a personal view. I am open-minded to both efficiencies and possible adverse competitive effects in vertical mergers, so I think we need to look at them. That said, it's fair enough to say that they are hard to think about. Some of the theories are what some people might characterize as delicate, and the analysis of vertical mergers is really fact-intensive. In general, I'm not going

to be able to give you a cookbook for how to investigate matters, and certainly not for vertical cases. I think there are facts and theories to examine. I can imagine our bringing cases. We certainly see a lot of claims about adverse vertical effects. While I am open-minded, I have to say that most of the stories I've heard so far were bad stories, and we rejected them all. But I'm open-minded, and I think the Division is, too.

**NELSON:** How do you evaluate materiality in the context of a vertical merger? Is the analysis different from the analysis in horizontal merger cases?

**KATZ:** It may sound too much like there's a single standard. What we do is weigh a bunch of different facts about the structure of the industry, how it behaves, and our confidence in the projections of effects. You could hypothesize a vertical type of competitive effect that may be harder to foresee and, thus, we'd be more cautious, and that would probably be a fair characterization of how I would proceed. But it's not like we say, "Here's the vertical and here's the horizontal." It's more that we assess whether we think these effects are going to be adverse to consumers and whether we have confidence in our projections.

**NELSON:** During the Reagan Administration, vertical restraints guidelines were written. When Anne Bingaman arrived, she repealed them. Have you or other people in the new administration looked at those standards and determined whether to use them or some similar standards?

**KATZ:** This may be revealing some sort of state secret: you need to have some market power somewhere or we're not going to be concerned. You don't need guidelines to tell you that, whether the guidelines are now out there, actively blessed or non-actively blessed. I don't know what else to say about that.

**NELSON:** Are there any rumblings about issuing new vertical guidelines?

**KATZ:** Not from me. We don't have any sort of announced effort to revisit those guidelines or put them out.

**AUDIENCE QUESTION:** How would you react to a simulation analysis that included efficiencies in the analysis, but still showed that there was a post-merger price increase?

**KATZ:** First, I would be pleased that you integrated the efficiencies analysis into the simulation because, as a matter of economics, it's a somewhat peculiar notion that you analyze competitive effects and then separately look at efficiencies. Particularly if one adopts the view that we're taking some sort of consumer harm as the welfare measure as opposed to overall economic efficiency, then you should integrate the two. Ultimately, you're asking the question of what happens to consumers from the net effect of all of these forces, and efficiencies are not some separate effect that takes place in isolation. They are part of the overall response to changes in the control and ownership of the firms. You should do that as an integrated analysis, and that's essentially what we do. You can talk about doing it in steps, but in the end, the simulation will push you toward an integrated analysis, and that is the right way to do it. You can build changes in firms' costs due to efficiencies into simulations, for example. Sometimes you think you've built everything into the model that will fit, but then you should do things in addition to the model, like try to understand how people in the industry think about



*Many merging parties seem to have given up trying to claim efficiencies, much to my disappointment. The difficulties arise from the fact that the efficiencies are projections, and firms often appear to have limited documentation for their projections.*

the industry. For instance, you need to understand the important effects that a one-shot model is going to miss; you should ask questions about innovation and strategic investment. You also want to ask yourself whether that pricing model fits the way the industry behaves. There are a lot of things that provide reality checks for a model. Do an old-fashioned case analysis and case study of the industry and see how the model looks in comparison—look for the factors that you’ve missed. Ask if there is anything one can do in terms of time series or cross-sectional studies to see whether the model generates predictions that are consistent with the actual experience of the industry. Also look to things less formal, not necessarily econometrics. For instance, are there any natural experiments that have happened in the industry in the past? Have there been similar mergers in the past? It’s all common sense. Given the type of deadlines we’re under, we sometimes need to remind ourselves to understand deeply how industries and institutions work on a practical level, and to make sure our models fit.

**AUDIENCE QUESTION:** On the question of efficiencies, are there particular types of economic analysis that you find helpful in testing efficiency claims?

**KATZ:** Yes. I’ll give you my personal opinion on efficiencies. Many merging parties seem to have given up trying to claim efficiencies, much to my disappointment. The difficulties arise from the fact that the efficiencies are projections, and firms often appear to have limited documentation for their projections. We often get simple spreadsheets that show how much money would be saved if all sorts of costs went down by, say, 3 percent a year for ten years. In some cases, it appears there is not a whole lot more to the analysis than that. But where did the percentage reductions come from?

There are things that you can do that are helpful. If you’re going to submit these parametric analyses, which in some ways are rules of thumb, tell us the basis of the rule of thumb. Obviously, the most helpful thing is if someone can come in and tell us “We merged before, here is what happened, and here’s why we can expect to repeat the cost savings.” Certainly in telecom there are possibilities for this sort of procedure because there are firms that merge repeatedly. So, one thing we would like to see is what happened in the past and what the experience has been. What sorts of costs were reduced? Now, I recognize that there may be business concerns when the cost analyses have been prepared by outside financial advisors. Investment banks may be reluctant to share how they do their analysis because they worry about it harming their own business. I respect the fact that they don’t want their trade secrets to leak out. Nevertheless, I think we need to see more back up. We need to see more about where the numbers came from because the stuff I tend to see—and tended to see as an expert before I was in the Division—was: here’s a spreadsheet, here are the cost savings, and look how big they are.

Then there is this process of saying “That doesn’t really sound like it’s specific to the merger.” Even that process can be reduced to staring at the spreadsheet and reading the headings on the columns and rows, asking, “Where did this come from and what’s really going on?” I think the only thing to do is get behind the cost savings projections. I would like to see parties bring in more information so that we could treat this stuff seriously.

**NELSON:** Does DOJ ever go back and ask, “Why did we lose this case?” More specifically, do you determine if you lost because your theoretical analysis was rejected? Do you go back to see if the facts that came out at trial are different from the facts that were believed to be true when the matter went through the DOJ front office?

**KATZ:** Before addressing the question, let me first make another point regarding the use of simulations and whether we find unilateral effects everywhere and then object to a slew of proposed mergers. We recently had a matter where we ran econometric studies and simulations—words that strike terror in the hearts of merging parties everywhere. The simulations produced small, but positive projected price changes. Even though the simulations projected adverse competitive effects, those results figured in the decision closing the investigation. We had not yet done the analysis with the projected efficiencies incorporated. The preliminary projections told us that it looked okay to close the matter without conducting a major efficiencies analysis. This example demonstrates that it is not the case that any time we find a projected positive effect on prices, off we go to challenge a merger. We have reality checks.

Now, let me return to the question of whether we go back and look at why we have lost in court in those matters where we unsuccessfully litigate. Our litigation performance is something we look at, and is something that we've looked at over a number of years. Different front offices do different things, but it's certainly something that we look at and I look at. I haven't done a comprehensive study yet, but I am planning to look at it in much more detail. There are times when we have not done a good job in court explaining, for example, how we think about market definition. That's something we need to work on, and I plan to work on it. As part of our internal process, it comes back to making sure we have a coherent, common sense story. As a matter of policy, if we don't have a story like that, it's going to make us nervous as to why we are bringing the case. And, of course, if we ever run into a situation where we went into court and it turned out we were completely wrong about what was happening in the industry, a lot of people in the Division are going to want to know why we were surprised. Certainly, the members of the trial team will take an intense interest, as would others.

**NELSON:** The FTC has done some impact evaluations where they review what happened in markets where they issued orders. Is there any thought about having the DOJ look at some of its historical orders?

**KATZ:** What they did was go back and look at the mergers they were concerned about but let go through, and ask whether they were right to be concerned, because that would provide information. My understanding, from talking to economists, is that our ability to do that is limited because, in terms of how we get data from people, it would be hard for the Division to do it. The Federal Trade Commission is in a much better position than we are to do retrospective studies, so we have to talk to them about doing that. It's certainly something that we'd be interested in doing, and I would love for people to voluntarily tell us what happened with prices, but our ability to collect the data is limited. We are thinking about various ways to try to get around the data limitations because we should test ourselves and we should go back and see how we were doing.

**NELSON:** I take it from your answer that there probably isn't any major shift in how you're thinking about the types of fixes you'll accept to solve problems raised by some mergers. Is it true that the policy of the preceding administration has pretty much been adopted by the current one in terms of the fixes that will solve issues raised by mergers?

**KATZ:** The only thing I can say on that is that we haven't done any sort of major economic study to rethink DOJ's approach to fixing mergers.

**AUDIENCE QUESTION:** With the increasing number of announcements that you will review con-

summed deals, how, if at all, does your economic perspective or study change when you look at small deals that are not HSR reportable?

**KATZ:** Well, the short answer is I don't know if it does. I mean, I haven't thought about it. Off the top of my head, I can't think of something that would be different, other than the scale of it. I haven't got anything in mind. It's wrong to think that we don't look at small deals and consider whether to challenge them, although I think we have some problems getting the data. The Division can challenge, does challenge, and has challenged things that fall under the filing requirements.

**AUDIENCE QUESTION:** You mentioned at one point during your discussion of unilateral effects analysis the effect on things other than price. I'm curious about how you analyze a unilateral effects case that does not have anything to do with price, whether it's an innovation question or a further products differentiation question.

**KATZ:** The analysis is the same as with price. If you thought we were just doing unilateral effects with simulations, you would think we were taking a narrower view than we actually do. Even if we're thinking about price, we try to understand the economic incentives of the firms to increase price and ask how those change with the merger. We would do the same thing with product quality or with innovation. We might ask if the reason one party was undertaking some program to innovate, for example, was explicit concern with the other party because there was some dimension along which the parties were the two primary competitors. So we'd basically conduct the same sort of analysis. We would ask, "Is there some reason to think that, within this broader market, this particular behavior is driven specifically by this other firm?" And if this behavior is important enough, and if we understand it well enough, then that would be the basis for being concerned about harm to competition.

**NELSON:** Do you think about competition between innovators as being similar to competition involving potential entrants? In other words, one firm has a product in one part of product space, the other one is innovating and might be moving or introducing a second product in another part of product space, and so you'd be thinking about it? For example, maybe both have heart drugs, but there are side effects and so one has a heart drug with one cluster of side effects and they're working on something that will reposition it and create a new drug that will have the same side effects as this merger partner, in which case you might be more concerned about that merger than you would be if that innovation effort wasn't ongoing.

**KATZ:** Certainly as a matter of economic theory you could have a case where you were worried about potential repositioning, driven by innovation, but that might be a hard case to litigate. Typically, potential entry cases are difficult, and it seems to me that this case would be doubly hard. But it's certainly something we could and, I think, would examine and analyze. If we thought we had really good evidence and a significant competitive effect, then we would bring the case. But there are a lot of hurdles you have to get over to get to the point of saying we have strong reasons and good evidence to believe this. I think the more likely scenario would be that you would see a firm with significant projects clearly aimed at the other firm, and that we would be worried about what would happen to those projects. It would be part of understanding the structure of the market and why we believe that these firms are particularly close to each other. Among some people complaining about unilateral effects, I'm sure there's a suspicion out there that we would say: "Well, these are the two firms merging. It would be nice if they were the neighbors and we could bring a unilateral effects

case; therefore, they must be neighbors, so go figure out how.” We don’t do that, and we need to make clear what we do instead. However, with repositioning, there can be a danger that you’re either going to do that unconsciously or it’s going to look like you’re doing it.

**ANTITRUST SOURCE:** The predicted price effects of Bertrand (differentiated product) models can (and frequently do) differ substantially between models assuming constant elasticity of demand and linear demand (with the former predicting much larger price increases). In the absence of sufficiently strong econometric way of distinguishing between those two alternatives, any ideas on how to choose one or the other?

**KATZ:** The fact that algebraic models can be sensitive to assumptions is one of the reasons that we must always test our models against reality. In addition to formal statistical studies, we would look for past episodes in the market to see what light they might shed on what would be likely to happen in the matter under consideration. We would also look for other evidence of how the market works. For example, customer and supplier interviews, as well as documents, might provide qualitative senses of the character of demand.

**AUDIENCE QUESTION:** Looking back at your time at the FCC, do you think you’re working with a different kind of standard today than when you were looking at mergers at the FCC? If so, does this difference affect your analysis?

**KATZ:** I’m not sure it affected the economics so much, but, yes, there was a different standard because the FCC has a broader, public interest standard. Certainly, when you examine media markets there’s an additional set of considerations that come into play at the FCC because the question involves issues of source diversity—going beyond being concerned about the commercial aspect, to being concerned with the effects on democratic society. Those sorts of issues don’t arise in the analysis we’re doing. In that sense, there clearly is a difference. Another difference you see, not so much in the analysis of the mergers, but certainly when you’re thinking about remedies, is that the Division generally does not want to be in the business of regulating industries and does not want to have a consent decree getting into the guts of the industry and taking a lot of work to oversee. The FCC is in that business, although it may not like it. The FCC clearly has a broader range of tools and things it can do for dealing with a merger. That affects how you think about the remedy, and some of that can feed back into your analysis of the merger itself.

**ANTITRUST SOURCE:** As is well known, your research on network effects has significantly influenced how economists approach antitrust in markets characterized by network effects (e.g., *MCI/Worldcom*, *Microsoft*). Do you see any need to revise the rules of the game (or reorder the rules) in matters involving network effects? Are the Guidelines still relevant for those purposes?

**KATZ:** I don’t think network effects create the need for a “new antitrust” or even for new merger guidelines. For one thing, network effects have long been important, and we have made it this far. Second, in many ways, network effects are just another form of increasing returns to scale. That said, I do think that standards and compatibility decisions raise interesting new dimensions of conduct to examine, and the importance of consumer expectations about future sales certainly adds to the complexity of analysis in novel ways. In the end, the possibility of network effects is another reason that we must examine the institutional and informational structure of markets in detail in order to

understand market behavior and competitive effects as well as we can. As in all of antitrust, analysts should be careful—and humble.

**AUDIENCE QUESTION:** Are there circumstances in which the Division would consider some sort of price regulation to compensate for a loss of competition or a substitute of competition?

**KATZ:** I'm not going to answer that question because the issue has already been raised publicly with regard to the proposed EchoStar-DirectTV deal; the question is too close to an actual case that's going to be in front of us. I will tell you we would look at the regulatory regime that's in place as part of understanding industry structure and understanding where things are. So certainly if you're in a case where there was price regulation at the time of the merger, we would take that into account in thinking about the competitive effect of the merger. The open question, which, as I said, I will explicitly avoid answering, is what if we were told in some merger, "Well, don't worry, there's this other regulatory body that's going to take care of the prices. They haven't yet, but they're going to." As I said, that is an issue we may well be confronting in the future.

**NELSON:** You indicated quite strongly that when you get into an econometric analysis in the context of a merger, you are encouraging parties to have some sort of dialogue and you indicated that it would be, in some cases, difficult to share the data because the data are proprietary. Would you be willing, even in those contexts, to go as far as sharing the functional form, the parameters, the econometric estimation approaches that were used, and the signs and significance of the coefficients? Even without sharing the values of the actual parameters or giving the data, there is a lot of information that could be shared. Would you be willing to open up the DOJ economists' analysis in ways that protect the confidential data, but provide the parties with detailed insights into the econometric studies that are being done by the DOJ staff? The FTC historically has not been willing to share this type of detailed information about their econometrics. As a result, it is somewhat unclear that the agencies are willing to share this type of information.

**KATZ:** I could be wrong because I wasn't in on all the details, but my understanding is that we've done that. I can't comment on the FTC, but the Division had a matter where I believe we told the parties everything except for giving them certain confidential data from third parties. The parties had their own data set on which they basically reran our regressions and then said, "Well, here's how we think you should change them." I remember seeing tables comparing their coefficients and ours, and we tried to tell them as much as we could about what we were doing.

**NELSON:** You were talking about looking at coordinated effects cases and looking at the indicia for tacit collusion (as opposed to explicit collusion). It has been my experience that some staff attorneys look at a history of whether there has been explicit collusion in the industry to assess whether tacit collusion is likely in the future or not. As an economist, this approach hasn't always struck me as a particularly sensible thing to do because, while you may get some information about the likelihood of collusion from explicit collusion cases, it may be that what led to explicit collusion is the fact that tacit collusion is unlikely to be successful, given the market's characteristics. Do you think a historical record of explicit collusion is relevant to the analysis of a merger?

**KATZ:** I think a record of historical collusion is a relevant factor. However, I would want to understand how the collusive scheme worked. This has come up in some investigations I've been

*I think a record of historical collusion is a relevant factor. However, I would want to understand how the collusive scheme worked. This has come up in some investigations I've been involved in. I want to know how this scheme worked, how broad did it have to be, how much detail, because, as you're saying, so many things can cut both ways. Understanding the scheme and what happened can give you a lot of insight into the workings of the market. One argument is that you've seen collusion is feasible, because they have done it. Then, the counter argument is that they had to do it illegally, so that shows how hard it must have been to do it tacitly. If you look at the actual workings of the scheme (see what the parties did and didn't know, see what information they might or might not have shared, see whether they allocated customers or colluded through prices), I think you can understand the workings of the industry better, but you don't want to do it by asking only whether they colluded or not. You want to do it by saying: "They colluded. Let's understand what happened then. Did it attract entrants? Did they have to take on new members, for example?" It's a good natural experiment. If people tell you entry is really easy, and then you say, "Well, that's interesting, but fifteen years ago the technology was the same and you guys colluded and you raised prices 20 percent, and nobody entered," how is that consistent with entry being so easy and holding prices to competitive levels? Now, that's not the way Phil was describing the investigatory process, which may be an accurate description of past practice. I described what we do now. I can't speak for the past.*

*worked. This has come up in some investigations I've been involved in. I want to know how this scheme worked, how broad did it have to be, how much detail, because, as you're saying, so many things can cut both ways.*

involved in. I want to know how this scheme worked, how broad did it have to be, how much detail, because, as you're saying, so many things can cut both ways. Understanding the scheme and what happened can give you a lot of insight into the workings of the market. One argument is that you've seen collusion is feasible, because they have done it. Then, the counter argument is that they had to do it illegally, so that shows how hard it must have been to do it tacitly. If you look at the actual workings of the scheme (see what the parties did and didn't know, see what information they might or might not have shared, see whether they allocated customers or colluded through prices), I think you can understand the workings of the industry better, but you don't want to do it by asking only whether they colluded or not. You want to do it by saying: "They colluded. Let's understand what happened then. Did it attract entrants? Did they have to take on new members, for example?" It's a good natural experiment. If people tell you entry is really easy, and then you say, "Well, that's interesting, but fifteen years ago the technology was the same and you guys colluded and you raised prices 20 percent, and nobody entered," how is that consistent with entry being so easy and holding prices to competitive levels? Now, that's not the way Phil was describing the investigatory process, which may be an accurate description of past practice. I described what we do now. I can't speak for the past.

**AUDIENCE QUESTION:** You talk about how it's difficult to evaluate efficiencies or that parties are not making a strong effort to adequately demonstrate efficiencies. That was discussed in the *Heinz* decision and it was an issue that came up in a Newport News transaction. How do you go about determining when efficiencies are strong enough or adequate enough to outweigh the loss of competition in a deal that's going from three to two, and can efficiencies ever justify a merger from two to one?

**KATZ:** That's a theoretical and a practical question. For the two-to-one merger, the answer, in theory, is yes. As a practical matter, I don't know. If you have an example, I'm happy to look at it; the staff would look at it and think it through. I think it's fair to say that even if we conclude that this unnamed merger is a two-to-one, we will think about it. How it will turn out, we'll have to see. We also have to examine whether it's really a two-to-one.

**NELSON:** One of the hot issues over the years has been the interface between intellectual property and antitrust. What things has the Division been thinking about doing to clarify its policies in this area?

**KATZ:** There are attempts in the sense that various deputies have gone out and spoken about it. I'm not sure if Charles James has specifically addressed that or not. One of the things we've said is there's no "convenient facilities doctrine." I think part of the problem in dealing with intellectual property is that people tend to think it doesn't really cost you anything if somebody else uses it, and it would be nice for them if they could use it, so we should let them do that. So, in that sense I think you could say the current version of the Justice Department comes out pretty strongly in favor of the intellectual property rights and doesn't see that you have a generic duty to deal or that there's something illicit about getting patents. We understand—and the Intellectual Property Guidelines have said—that while licensing is a good thing, you don't have an obligation to grant a license to anybody who wants one. Of course, you can abuse the licensing process, and we'll look at it, but it's going to be within the confines of antitrust law, and we're not going to say that somehow intellectual property creates extra obligations on you.



**AUDIENCE QUESTION:** What published articles, not working papers, in the economics or law and economics literature have you read over the past three to five years that have most influenced your views on Industrial Organization theory (“IO”) and antitrust law?

*So I spend a fair amount of time trying to get a much sharper understanding about how the courts think about antitrust economics, which is not always in accord with how economists think.*

**KATZ:** I can’t think of anything that’s had a big influence on how I think about it. I will tell you about what I read. I have a stack of various appellate court decisions. I’ve been spending my time reading through those because, in the end, even if a matter doesn’t go to litigation, we’re supposed to be enforcing the law. So I spend a fair amount of time trying to get a much sharper understanding about how the courts think about antitrust economics, which is not always in accord with how economists think. Academic economists often say the courts don’t really understand us, and then off they go to do their thing. Academic economists—if we’re going to make progress in this area—need to understand a lot better how and why the courts think about antitrust issues. So part of what I’ve been doing is trying to get a much better sense of the mindset of the courts. Economists probably should have more sensitivity in thinking about the theoretical approach. Economists should think about the real problems the courts face. In academic research, one can write down a formal model and say, in this model, this practice has these effects. Then you can write down a second model in which the practice has different effects. You have two completely rigorous analyses. The problem is, the court has to know, when it is confronted with a cross-section of cases, is it likely to be in this world or that world? If I take a given action, I know that in some models what I’m going to do is a good thing and in some it’s a bad thing. Well, how do I know I’m right more often than not? Economics, in general, hasn’t done a very good job of answering that sort of question. Academic economists tend not to be very good at giving good rules of thumb. We tend to be very good at taking a particular thing and analyzing it to death. That’s one of the reasons for not pointing to an individual article that I would say has really shaped how I think about IO and antitrust law. If there were an article that said “Here’s how we should balance the realities of what actually happens either in investigating a matter or litigating it,” then that would become the article, but I haven’t seen one like that. Articles tend to present a specific model, a specific topic, and provide incremental information.

**AUDIENCE QUESTION:** What appellate cases have you read?

**KATZ:** I don’t think I could single one out. Basically, I’m just trying to read strings of cases. For instance, I’ve been reading a string of decisions on exclusive dealing and working backwards on that, and I have been reading a group of cases on predation. I’d have to say that detailed economic models pretty clearly say that the way many courts analyze predation is incorrect. For example, the search for the “right” cost floor is wrong because there isn’t a right cost floor. For any cost floor you can come up with, I can come up with a model in which it’s the wrong floor. So the real question we face is: What’s the right rule on average? Unfortunately, I don’t think economists have taken a really good look at that, although some academic economists have taken this on in a separate law review literature. I have read other cases as well, like *Stearns Airport Equip. Co. v. FMC Corp.*, (170 F.3d 518) in which I learned about the differences in electromechanical and hydraulic jetways. It’s not as if I look at one particular thing that has changed my way of thinking about stuff, if for no other reason than the decisions tend to be so incremental until you go back forty years or so.

**AUDIENCE QUESTION:** Could you ever have competitive injury or anticompetitive effects in an attempted monopolization case based on predatory pricing? As an economist, would you say that you could never have anticompetitive effects in a case involving predatory pricing by a firm whose

market share is such that a monopolization case cannot be brought, so an attempted monopolization case is brought, instead?

**KATZ:** As a matter of theory, I would not say “never.” I can write down a model in which a firm has a small market share and can engage in predation that harms consumers. That’s a different question than asking if I can point to any markets that actually look like that. Again, it’s something I’m certainly not going to rule out as a matter of theory. I’m fond of saying that there is no general theorem in antitrust economics except the one that says there are no other general theorems. Hypothetically, there are situations in which almost anything can happen and that’s one of the problems I have with some of the claims that have come out of the Chicago school of antitrust. The good thing about the Chicago school was that, compared to what was being done before it came along, it increased the level of rigor and analysis. The bad thing about it is that it pushed the completely false notion that you could have a two-line proof that there was no such thing as predation. Things are just too industry specific and too fact intensive. Never say never; but that said, it’s one thing to come up with a theoretical curiosity, and it is another really to build a case.

You’re going to keep getting these on-the-one-hand/on-the-other-hand economist answers, but I think that’s really the right approach. ●

## Interview with Deborah Majoras, Deputy Assistant Attorney General, U.S. Department of Justice, Antitrust Division



Deborah Platt Majoras

**Ed. Note:** *Deborah Platt Majoras is the Deputy Assistant Attorney General with lead responsibility for civil enforcement, and under the recent reorganization is supervising Litigation I, II, and III, which includes what was formerly known as the Civil Task Force. Ms. Majoras was the first antitrust official of President George W. Bush's administration to arrive at the Antitrust Division. Her arrival coincided with the GE/Honeywell investigation, giving her just enough time to meet with her counterparts at the European Commission before they denied the deal. Ms. Majoras has also taken the lead supervisory role in the case against Microsoft Corp.*

*Ms. Majoras was interviewed for this article by the editors of The Antitrust Source on January 28, 2002. In this interview, Ms. Majoras discusses, among other topics, the goals of the current administration, the rationale for the Division's reorganization, the Merger Review Initiative, and the Department's approach to high-tech merger investigations.*

*Ms. Majoras comes to the Division from Jones, Day, Reavis and Pogue where, as a partner in the Antitrust and Trade Regulation Section, she was actively involved in criminal and civil antitrust litigation. She arrived at Jones, Day in 1991 after clerking for Judge Stanley S. Harris, United States District Court for the District of Columbia. Ms. Majoras received her J.D. in 1989 from the University of Virginia, where she was a member of the Order of the Coif as well as Articles Editor, Law Review. She earned a Bachelor of Arts, Westminster College summa cum laude in 1985.*

—Richard C. Park

---

**ANTITRUST SOURCE:** A reorganization of the Antitrust Division was announced on January 4, 2002. Can you tell us what your responsibilities include now, and how everybody else's responsibilities have been defined in the wake of that announcement?

**MAJORAS:** As you know, when I first arrived I was the only civil deputy for a short period of time and so I dabbled in just about everything. I took the initial month or two to spend some time visiting with the sections, learning more about the Division, and figuring out whether the structure was appropriate for the most effective and efficient antitrust enforcement. When Charles and the other deputies arrived, they did some of the same and we devised a reorganization plan for the Division. That plan culminated in our getting approval from our appropriations committees in Congress to implement this reorganization, which actually is not major, but nonetheless is important. My responsibilities have not changed much under the reorganization. I will now have supervisory responsibility over our new Litigation I section, Litigation II, which remains the same although will be somewhat downsized, and Litigation III which was previously the Civil Task Force. I previously had responsibility for Civil Task Force and Litigation II, so generally speaking my responsibility will stay the same. I will retain supervision over the *Microsoft* case, even though that may end up in a section that I do not otherwise supervise.

**ANTITRUST SOURCE:** What is new Litigation I?

**MAJORAS:** I say “new” because Litigation I previously had been the criminal enforcement section in D.C., which is now going to be referred to as National Criminal Enforcement. Litigation I is being formed out of part of Litigation II and some other commodities and personnel from some other sections. I can’t tell you just yet exactly what commodities it will focus on because we are working on that now, but one of the key changes in the reorganization is that we have eliminated any hard break between merger and non-merger enforcement. So, for example, previously Litigation II only did merger enforcement work and Civil Task Force was actually formed to focus on non-merger investigations. Over time, particularly during the merger wave, Civil Task Force ended up doing a lot of merger work in any event. A very important reason for the change is that we want every section to have a portfolio of products and services, and to have the staff, chief, and assistant chief of those sections be very focused on those areas and be able to engage in what we call community policing—really getting out there in the community, speaking with trade associations, and being known to the leaders of those industries—so that we can have the sort of interaction that makes for very effective antitrust enforcement.

**ANTITRUST SOURCE:** Is the idea that the various sections will be organized along industry lines?

**MAJORAS:** Yes, there will be six civil litigating sections. The three I did not mention are Telecommunications and Media, Transportation, Energy and Agriculture, and what we are now calling Networks and Technology, which was previously Computers and Finance. Those sections previously existed, although Telecom was the Telecommunications Task Force, and we have now made it a full-fledged section. By and large, the commodities in these sections will remain the same, with probably some shifting to do some rationalization. Those three sections, with the exception of the computer industry, are what we refer to as the regulated industry sections, and they are under the supervision of Hew Pate, one of my fellow deputies. What we are doing with the other sections now, Litigation I, II, and III, is giving them more focus within their own portfolios. There will always be overlaps among portfolios and new products that emerge that nobody ever would have thought of, but nonetheless, we are trying to give each of the sections true focus.

**ANTITRUST SOURCE:** A lot of expertise was developed at the DOJ to deal with the *Microsoft* case. Assuming the settlement is approved, will these resources be redeployed to other cases involving the same industry? To cases involving single firm conduct?

**MAJORAS:** What we are trying to do in the Division is take expertise, like that we gained in software and other related industries in *Microsoft*, and concentrate it in sections, turning our lawyers loose a bit so that they are not just waiting for the next merger to come in, but are out looking at and studying these industries and determining where we might want to open investigations and ultimately bring cases. Specifically in answer to your question, if you look at the way high-tech industries and products are developing, it’s certainly conceivable that there will be other monopolization cases to look at in the future. And, yes, we have people who have gained vast knowledge in this industry and also in these theories, and it would make great sense to have these people continue to work in this area.

**ANTITRUST SOURCE:** You have described your responsibilities and Hew Pate's. What are the others'?

**MAJORAS:** Bill Kolasky is the international deputy, Michael Katz is the economics deputy, and Jim Griffin, who is not new to the Division, is the deputy for criminal enforcement.

**ANTITRUST SOURCE:** What would you say the differences are in priorities between this administration and the last?

**MAJORAS:** I actually get that question a lot and it is an interesting one. Believe it or not, we really don't assess what we are doing by comparing ourselves to the last administration. We haven't even tried to do it that way. The Antitrust Division has an unbelievably professional and dedicated group of lawyers and economists, and even as there are changes made in the front office, they just keep working and doing what they are doing. That makes good sense because even if one wanted to politicize antitrust enforcement, and I am not suggesting that one should, there is truly a bipartisan mandate for strong antitrust enforcement, so we will be working accordingly.

Now, one change obviously is the type and number of matters that come before the Division. We don't have a merger wave going on right now. In fact, it is quite the opposite. When I recently looked at merger statistics, I saw that for fiscal year 2002, which began in September, HSR filings were down by more than two-thirds over what they were in FY 2001. Some of that is because of the change in thresholds, but nonetheless, there obviously are some changes in the economy that are dictating that as well. Even though we have fewer HSR-reportable mergers to review, that does not mean we can't or won't look at mergers below the threshold. We have already done that once, and we won't hesitate to do it if we see an anticompetitive problem. We are an enforcement agency. If you look at our front office, we come to this as antitrust lawyers, not politicians. As we see it, we are the referees whose agendas are going to be influenced by what is going on out there in the marketplace.

Nonetheless, there is some prioritization; obviously Charles has placed international enforcement and relations with enforcement agencies around the world high on his agenda. You can see that simply by virtue of the fact that he is dedicating one very smart and capable deputy to be the international deputy. There is a lot of work that remains to be done in that area. Obviously, we, as well as the FTC, are placing a high level of emphasis on issues relating to intellectual property, exploring those issues in antitrust terms. As you know, the FTC and DOJ will jointly hold hearings on intellectual property issues and antitrust starting in early February. This is the first time that the Department of Justice has ever hosted such hearings. We think that dialogue and discussion are very important, and you might see us focusing more on intellectual property. Obviously, we care most about horizontal conduct, but we are going to go beyond the typical merger filings, and we are very interested in looking at the various strategic alliances and joint ventures that are being formed in many industries. We will look at these and see whether, in fact, the right kinds of integration and legitimate efficiencies are being achieved, as opposed to just eliminating a competitor and making life easier for a couple of competitors. So I think you will see us being fairly active in that arena.

**ANTITRUST SOURCE:** I noticed that you didn't mention monopolization cases. Is that intentional?

**MAJORAS:** No, it is not intentional. I think the fact is that as we look at the way product markets

*Obviously, we care most about horizontal conduct, but we are going to go beyond the typical merger filings, and we are very interested in looking at the various strategic alliances and joint ventures that are being formed in many industries.*

*[A]s we look at the way product markets are developing in high-tech industries, single firm behavior is going to be an important part of our enforcement efforts, or at least our investigatory efforts, on a going forward basis.*

are developing in high-tech industries, single firm behavior is going to be an important part of our enforcement efforts, or at least our investigatory efforts, on a going forward basis.

**ANTITRUST SOURCE:** How will the intellectual property hearings that you and the FTC are going to conduct affect the Division's enforcement efforts in the area of intellectual property? Are you going to want to assess what you get in those hearings before you begin major enforcement initiatives, or is there no relationship between the two?

**MAJORAS:** The interesting thing about antitrust enforcement and the antitrust bar is that there is almost no chicken and no egg in terms of study and learning and actually bringing cases. So, for example, both the FTC and the Department of Justice have already brought cases and entered into consent decrees in which intellectual property was a very important part of whatever action was taken and needed to be dealt with accordingly. We don't have a master plan for suddenly increasing enforcement of the antitrust laws in industries and products in which intellectual property plays a key role. We want to look at these issues in the hearings very closely, and I think it is fair to say that our learning in these hearings will affect our future enforcement. Obviously, we already have in place IP Guidelines. We are following those principles; we are not making some effort to suddenly throw those out, but, on the other hand, this is a very dynamic and important area. It is an area in which, while IP and antitrust don't have to conflict, it is at least perceived that they do. Courts are heading in different directions on these issues, and we are anxious to have these hearings to get the views of many experienced and smart people in this area and determine then how that should affect our enforcement efforts going forward. Conversely, I think every enforcement action we bring in which IP has prominence can then be used for further study, and we can look and see what has been effective and what hasn't.

**ANTITRUST SOURCE:** Has there been any thought given to whether there will be new IP guidelines issued during this administration?

**MAJORAS:** Hard to say. We did not come in with the view that guidelines are something that we are going to try to do. I won't rule out that any guidelines could be issued during this administration. It is possible that they could be. The thing about guidelines is that they are really only useful if consensus is pretty fairly developed for how enforcement should work. Otherwise they are hardly worth the paper they are printed on. So that is the difficult thing about guidelines. On the one hand, they are really useful for businesses and for antitrust lawyers and economists to be able to evaluate conduct and mergers, which I think has a huge benefit for all of the economy and for society. On the other hand, if businesses and others are actually relying on guidelines that in fact are not consistent with solid economic thinking and case law, then they are probably counter-productive. So it is a tough thing to determine, and there is no point in doing guidelines if we don't think there is something new and useful to say that folks can rely on.

**ANTITRUST SOURCE:** Is the Division looking for opportunities to submit amicus briefs in circuit court cases that present conflicts between intellectual property laws and antitrust laws?

**MAJORAS:** We are looking at important cases in many different areas of antitrust to determine whether filing an amicus brief would be useful to the court and useful for the integrity of future antitrust enforcement, and certainly IP falls in that area. In fact, in many cases we don't even have to be look-



ing, because we are often asked by courts and by others to step into the fray.

**ANTITRUST SOURCE:** Would it be fair to say that, if you found that the Guidelines were not consistent with existing case law or the consensus around them had evaporated to some extent, that the Department would consider changing or updating or even abandoning certain guidelines?

**MAJORAS:** That certainly could be the case, but only if legal and economic consensus counsels that such a serious step is necessary. For example, right now there are some members of the bar and economists who are looking at the Horizontal Merger Guidelines to determine whether their underpinnings are still valid and whether those guidelines are still serving the purpose they are supposed to serve. Now, the fact of the matter is that no one, at least to my knowledge, has come up with anything better yet. So my view on the Horizontal Merger Guidelines is that there is still plenty of economic and legal consensus. Indeed, if you look today at courts and the opinions they are writing, they are looking at our guidelines, determining that they are consistent with past case law, by and large, and basically applying them or their principles. So, I certainly think we are a long way from throwing them out. On the other hand, I do think it is healthy for us to continue to look at how our laws are developing, how relevant economics is developing, and how well the guidelines are working.

**ANTITRUST SOURCE:** If someone were of the opinion that certain guidelines were out of whack with the consensus of the economic or legal community, what is the best way to bring that to the Division's attention?

**MAJORAS:** There are several ways. Publishing papers and participating in seminars can be very helpful to start the dialogue. We, at the agencies, can invite some of that dialogue ourselves, both formally through hearings and more informally. At a point when issues and positions have crystallized to a fair degree, hearings can be an important way to get a variety of viewpoints and get them out publicly so that all who are interested can participate and take a look. I know that before the joint venture guidelines were promulgated, there were hearings and various viewpoints were presented.

**ANTITRUST SOURCE:** Charles James embarked on his job confessing some frustration with DOJ as a merger lawyer, and that was the inspiration for some of the aspects of the Merger Review Initiative. Can you tell us where the Initiative stands now?

**MAJORAS:** The Merger Review Initiative has been implemented. Now, we have not had much experience with the Initiative. Once again, we simply haven't had a critical mass of mergers to try it out on. Basically, what we are working to achieve is more aggressive investigation during the first thirty-day period, including early consultations with the parties to try and get on the same page. Then, if a second request needs to be issued, we are using what we have learned in the first thirty days to narrow it. Going forward from there, we want to put into place regular consultations between the parties and the Division—up to and including written letter agreements between the Division and the parties' lawyers that set forth steps on timing—some steps that hopefully can manage burden, but won't put any of us in a bad position going forward if in fact we end up in litigation. The key to this is to have a two-way street. We have had some initial success with it. By that I mean we have had some investigations that I think were conducted more efficiently and productively than they would have been had we not set the staff loose to really use judgment and get

the investigation narrowed and not worry about all the issues right up front. I have heard some very positive feedback from our staff and from economists and lawyers on the other side about a couple of investigations. So, again I think it has promise. I have also had one or two mergers in which staff lawyers have come to me and said, "Gee, I don't think this worked as well." In one matter, the parties were really jerking us around and trying to make it one-sided so that we were giving a lot to reduce burden but not getting much in return. Lawyers can certainly play it that way, but it will not be very effective on either side. And, in addition, our staff knows that if they work with particular lawyers and these things don't work out, they don't necessarily have to offer such an agreement or such measures in the future.

**ANTITRUST SOURCE:** In the instances where you feel it has worked well, have the mergers been allowed to occur or have they been stopped?

**MAJORAS:** The only examples that I am thinking of have been allowed to proceed.

**ANTITRUST SOURCE:** With conditions that were identified or without?

**MAJORAS:** The ones I am thinking of now were without. Second requests were issued and an investigation was conducted. There was very good dialogue between the parties and the Division, and ultimately we determined that an enforcement action was not appropriate.

**ANTITRUST SOURCE:** In some of its manifestations, the process calls for people to stipulate to geographic and product markets. If a case like that is later litigated, will the participants be stuck with those stipulations?

**MAJORAS:** It depends on the situation. First of all, the most important thing to remember about the Initiative is that it is intended to be flexible. The investigation plans and any timing and other arrangements with the parties are suppose to be tailored to exactly what is needed in a particular matter. Part of the reason for this is it seemed that there were too many instances in which, for example, the same model second request was being used over and over again, even when certain types of inquiries were not appropriate to the investigation and they may have been negotiated out eventually. So we really want these plans to be tailored. It will not always be the case that parties will be asked to stipulate to a particular market. Suppose you have a matter in which, as is often the case, it is fairly clear that the market will be the United States. But the real issue is going to be how the product market is defined. For purposes of trying to arrive at the right answer, whether an enforcement action ought to be taken, why bother dealing with issues of geographic market during the investigatory period? We can stipulate during the investigation that the geographic market is the United States. Now, suppose we focus primarily on the product issues and then we get to the point where we say we intend to bring a case. We understand that we don't entirely agree on the geographic market and that parties might want to fight the action on every single ground, so we can dissolve that stipulation, and make sure that nobody is hurt by it by agreeing that each side will be entitled to proper discovery on that issue. In fact, you can imagine the scenario, which I think has already happened and has been successful, in which we take a very close look at a product market or other issue and ultimately determine that on that key issue, it is not appropriate for us to bring an enforcement action. Then we haven't all wasted a lot of time preparing our litigation issues.

*[T]he clearance process works very well in a high percentage of cases; it is just that in a number of high profile and other matters there has been contentiousness, given the convergence of various industries. I am afraid the number of those has grown, and there were some matters sitting in clearance for quite some time when we got here, and we resolved to try to do something about it.*

**ANTITRUST SOURCE:** The idea would be that such a stipulation in a pre-merger context would not be cited for or against any party in a litigation?

**MAJORAS:** No, and that can be made clear. Again, if everybody agrees that the stipulation should govern in litigation, it can. If that initial letter agreement says we are stipulating to geographic market now during the investigation and for litigation purposes, then, sure, we would cite it. If it is just for the purposes of the investigation, then, no, we wouldn't cite it.

**ANTITRUST SOURCE:** What about the Clearance Procedure Agreement? Can you tell us what its status is and what its fate is likely to be?

**MAJORAS:** Well, its status is on hold for the moment. Unfortunately, it has been sidetracked for all of the wrong reasons. Indeed, I think it is fair to say the factors that underlie any opposition to it underscore the very reasons why we need it. Maybe I haven't been in Washington long enough, but I am still optimistic that because this is "good government" and it needs to be done, ultimately it will be done. The Department is very supportive of doing it. It has just been put on hold for a bit while we have some discussion with a few members of Congress.

**ANTITRUST SOURCE:** In the interim, will the FTC and the Division be abiding by the proposed terms of the agreement?

**MAJORAS:** In the interim, we are resolving clearance in the way that we always have, based on the experience of the agencies in the particular product or service. There are several things in the agreement, including timing agreements for getting clearance decided faster, and other really important things. Those, of course, have not been highlighted in the press because they are not controversial enough. The controversial part is the allocation of responsibilities, and what is interesting about a lot of the pushback on the allocation is that it is just simply puts into an agreement what we already do. For example, when pharmaceutical matters come up, everybody knows that the FTC generally gets those. When telecom matters come up, everyone knows the DOJ generally gets those. The controversy that has surrounded the proposed agreement is curious, but I am hoping that with education we will overcome it.

**ANTITRUST SOURCE:** Does the way that this has unfolded create the possibility of making the clearance procedure more contentious, at least in the near future?

**MAJORAS:** I hope not. I think the fact of the matter is nobody involved in either agency who steps back from this process can say that we should do anything but get matters cleared quickly and get on with our investigations. That is the only "good government" way to do it. Tim Muris and Charles and folks who work for them, including me, are very committed to trying to improve the process. The fact is the clearance process works very well in a high percentage of cases; it is just that in a number of high profile and other matters there has been contentiousness, given the convergence of various industries. I am afraid the number of those has grown, and there were some matters sitting in clearance for quite some time when we got here, and we resolved to try to do something about it. Again, I am optimistic that this agreement will work out and if it doesn't, I am equally optimistic that we will work to do the right thing, albeit in a different way.

**ANTITRUST SOURCE:** Are you approaching mergers in the high-tech field any differently?

**MAJORAS:** When I have talked about this before, I was asked whether there ought to be separate guidelines for high-tech mergers. What I had said then, and what I will say to you, is that we are still using the Horizontal Merger Guidelines in assessing mergers, no matter what type of industry they may be in. If those Guidelines are used the way they are supposed to be used, which is flexibly and engaging in the right kind of fact-based analysis, then the sort of factors that distinguish high-tech-type markets from others will be taken into account in the Horizontal Guidelines merger analysis, as they should be. And so while I recognize that may not be the most satisfying of answers to some, what it means is we will take into account the characteristics in the particular marketplace. There is no special formula for doing high tech any differently than we do others.

**ANTITRUST SOURCE:** There has been a lot of commentary that high-tech markets are evolving so quickly that antitrust enforcers have a difficult time keeping up with them and having the remedies they are seeking continue to be relevant. What is your philosophy about that concern and how do you propose to deal with it in terms of your enforcement efforts, both merger and non-merger?

**MAJORAS:** Our view is that antitrust enforcement can keep up with rapidly changing markets. While speed may be essential, speed has often been essential in all kinds of markets throughout the history of antitrust enforcement. So our view is that, yes, the antitrust enforcement mechanisms that we have in place are adequate to keep up with evolving technology markets. Now, it is true that as enforcement and litigation proceed over time, markets can change and so evidence and, potentially, remedies have to be studied very carefully to determine whether they are still relevant to what is really going on in the market place. That is key. But it certainly can be done, and the alternative is some form of regulation in these industries. For example, I hear a lot of people say that because of the nature of networks in high-tech industries, antitrust enforcement may not be adequate because we can't enforce quickly enough before the market gets "tipped" to one particular player and that once this occurs the player will have taken the market and there will be little the Division can do to fix it. We are aware of those tendencies in certain markets, and we account for that. We also have to remember that the carrot that is held out there in all industries is that a company could be so good that it gets to be the only one, and we don't want to squelch the R&D and the hard work that is spawned when a company wants to be the primary provider of any particular service or product. So we have to be careful about that, and I don't believe that regulation would work as well in that regard because regulation wouldn't keep up any faster than case-by-case enforcement, and it has some down side. It can chill innovation and chill enthusiasm for companies, and I still think that our system of taking cases as they come, by investigation, and ultimately by bringing cases, is the better way to continue.

**ANTITRUST SOURCE:** To what extent do you think DOJ should share its analysis with parties to a merger so that the other side can offer a rebuttal prior to litigation getting started?

**MAJORAS:** In general, our thinking should be shared. I think the element of surprise is overrated. Those who are defending themselves need to understand where we are headed. It means that we can structure an investigation that is tailored to what it is we are really thinking and have the parties behaving cooperatively so that we can actually get the work done more efficiently and effectively. And frankly, as a lawyer, I want to know what the defense is. Having said that, it is kind of hard to

demand full antitrust analysis two weeks after you file your HSR. The level of discussion, and our ability to be able to lay cards on the table, is obviously going to be influenced by how quickly we are getting the materials and how much time we have had to analyze them. The dialogue, however, will not be effective if the parties will not engage.

**ANTITRUST SOURCE:** In terms of your philosophy that the government ought to share its current thinking with merging parties, what are you doing to transmit that message down the line to staff that are actually on the front lines dealing with the parties' counsel?

**MAJORAS:** First, we rolled out our Merger Process Initiative to our staff and discussed our willingness to be open as one of the points that is important to us, but not because we want to be nice to parties. That's not it. It's because, again, we think the investigation would be far more effective if we have a dialogue. In addition, at the deputy level, we are getting involved in investigations fairly early. So we are working together with our staff in terms of the extent of dialogue with the parties, including dialogue between economists. I think sometimes, some folks were worried that might give away too much, too early. But if they have someone in the front office agreeing this is worth doing, then that gives some reassurance and makes people more comfortable about doing it. So those are a couple of the ways in which we are communicating it.

**ANTITRUST SOURCE:** You have in the past suggested that there has been too much reliance on unilateral effects theories and that not enough attention has been given to coordinated interaction type of affects. Can you discuss why that is true and give some examples?

**MAJORAS:** I think that is a bit of an overstatement of what I had said previously. As you know, David Scheffman at the FTC and some others have been raising questions about whether unilateral effects analysis is being used almost exclusively now, and whether coordinated interaction possibilities are essentially being ignored. I think it is absolutely an issue worth exploring. If you look at the cases that are being brought, almost all of them are being brought under unilateral effects theories. So that's interesting. And one could say the reason for that is because all the cases that are being brought today involve differentiated products, and coordinated interaction would just be impossible. That might be true. Once we do the concentration analysis, if we find high levels of concentration, the competitive effects analysis must be a separate step. In other words, we can't just assume that because HHIs are high, there must be an anticompetitive effect. I want to make sure that we are being disciplined in that analysis.

**ANTITRUST SOURCE:** How do you think the Division ought to weigh the benefits of econometric or simulation analyses of merger against the cost to the parties of supplying the Division with that kind of data to support the modeling?

**MAJORAS:** I understand that data gathering, particularly to get it in the form that can be useful to econometricians, can be burdensome. I've been on the other side; I've done it. However, sometimes, it is not that burdensome and so it is a knee jerk reaction for a lot parties to come in and immediately say that providing data is just too burdensome and they can't do it. We end up doing this dance for three or four months and eventually we get it anyway. What is terribly troubling is when, at the end of doing this dance, we find out that the parties' economists have had data they have been working with all along. Some of the game playing that goes on with respect to sharing analyses is just

*I know in the past there was at least a perception in the bar that the FTC was demanding up-front buyers, and I believe there was some of that. And so in that respect, yes, I would say the Antitrust Division has differed. Up-front buyers have not been, and are not today, a requirement.*

absolutely unhelpful. Having said all that, my view in general is that when we conduct an investigation, we should always weigh the burdens on the parties and the costs versus the likelihood that it will provide anything useful to us in trying to determine the competitive implications of a particular deal. So if, for example, we had a situation in which documents and interviews were revealing that, despite high concentration levels, we really ought not be worried about the competitive implications of a particular deal, deciding anyway to go forward and make the parties work really, really hard to give us data in a particular form and so forth just in case econometrically we might be able to make the case, I would say is not a balancing that I would do. Now part of that is because I don't believe we should be bringing cases based solely on econometrics when the empirical evidence is not there to support the econometric simulation or theory. So in those cases, I think it is more likely to be a waste of time. On the other hand, particularly in the area of consumer products, obviously econometric studies have been shown to be useful in merger review.

**ANTITRUST SOURCE:** Does the DOJ approach the issue of up-front buyers differently from the FTC? If a buyer is put forward for the DOJ to consider will you accept the buyer's view about whether it thinks the divested assets are good enough to enable them to compete effectively?

**MAJORAS:** I don't know exactly how the FTC is currently approaching it. I know in the past there was at least a perception in the bar that the FTC was demanding up-front buyers, and I believe there was some of that. And so in that respect, yes, I would say the Antitrust Division has differed. Up-front buyers have not been, and are not today, a requirement. They can be useful, though, and are something that we would consider in terms of whether we would accept a buyer's assessment that, "I am buying these assets, so clearly I think that this bundle is strong enough to compete." Will we take that at face value? No, though obviously that is an important indicator for us. It's important to let the market speak whenever we can and that is one way in which the market can speak. On the other hand, we still have to take a close look at the buyer's plans and incentives. Just because it is a sophisticated buyer with financial resources doesn't mean that it will necessarily use those assets in a way that is important to the marketplace, which is changing as a result of a merger. So, we look at the whole deal that the up-front buyer has cut. Are there advantages that the buyer is getting other than particular assets that would make this buyer really want to do this deal, whether or not these assets ever succeed or not? Will this vertically integrate the buyer, so that now the buyer will only be using the assets in a captive fashion? These are all things that we would look at, but we are flexible in the analysis of assessing buyers, whether upfront or not.

**ANTITRUST SOURCE:** Talking about enforcement emphasis, do you think there will be an increased likelihood or increased emphasis on litigating mergers at the DOJ? You said earlier that with the slackening pace of merger activity that there weren't as many mergers to focus on. Is the result of that going to be more focus on the ones that there are or a more intense focus on non-merger activity?

**MAJORAS:** That is an interesting question. I haven't been at the Division during a merger wave, so I don't know whether there were certain mergers that were not subject to enforcement actions because, for example, they weren't "low hanging fruit" compared to some of the other mergers that we were seeing. Obviously, it is always our job to balance our resources and so forth so it is conceivable that that could happen. It is also the case that this will give us an opportunity to focus more on non-merger conduct investigations. This time is also enabling us to get our house in order in terms



of our reorganization and getting the various sections focused on doing merger and non-merger investigations within their bundles of responsibility. We will litigate when we believe that an enforcement action is appropriate.

**ANTITRUST SOURCE:** Do you think that DOJ is going to get into the business of challenging mergers after they have closed?

**MAJORAS:** That is hard to say in the abstract. We definitely have third parties who come to us and complain about mergers even after they have closed—sometimes well after they have closed. Obviously, our obligations as antitrust enforcers don't stop at the conclusion of the HSR process. So, it's entirely conceivable that we could bring cases like that. But, we are not out looking for them just for the sake of bringing them as a warning. I think that, in fact, for efficiency and competition reasons, all of us have benefited greatly from an enforcement action that appropriately stops a transaction from going forward, rather than trying to undo it after the fact. That's the whole basis for HSR. So, we should endeavor to cast the net out widely enough, so that we can get the anti-competitive mergers before they get through. Having said that, what we do in HSR review and other merger review is necessarily predictive in nature and that means it's imperfect. Just because companies are actually permitted to merge doesn't mean that there will never be an investigation of the merger going forward.

*[We have had great relationships [with the states] over the years, and there are good reasons why that should continue, including economies and not subjecting parties to dual and different enforcement.*

**ANTITRUST SOURCE:** Can I ask you some questions about *Microsoft*?

**MAJORAS:** I will answer them or not answer them, depending upon what they are.

**ANTITRUST SOURCE:** Does the fact that the states split into two groups, one supporting the settlement and one not supporting the settlement, bode any changes in the way that the DOJ and states will work together in the future?

*There are great reasons to work closely together and we have plans to do that, but obviously the Microsoft experience gives us some things we need to talk about going forward.*

**MAJORAS:** Well, I hope not. I will say a couple of things. First of all, whenever you represent a party in a joint plaintiff or joint defense relationship, there is always the possibility that at some point interests may diverge and parties go their separate ways. The same was certainly true when I was on the joint defense side. So that by itself is absolutely fine and appropriate as we go forward. The only thing that I am taking a very close look at, however, is when we were working on the *Microsoft* case with the states, we were told that our high level of openness and cooperation with the states was unprecedented. The fact that we were constantly sitting down with them all the way up to the level of Charles, and talking through theories and possible remedies, is something that was unprecedented. We thought that that was absolutely the way to do it. It is fine for the other states, having heard all of that, to go their own separate ways. But, I think it is not fine to then have heaped on us, because of all the lobbying going on, that we somehow shut them out of the process. That is just flat out wrong. Any state that wanted to participate in our thinking and in the process was invited to do so; some just chose not to. Also, some of the public criticism of us lobbed by some of the states that didn't settle, I think, is just unproductive and, of course, it makes it harder to think that you always want to be so open with your co-party if you believe not only that they might go their separate ways, which is fine, but once doing that and knowing what you are thinking that they might then tell the world that you are doing something wrong. That is a little bit trickier. But having said all that, we have had great relationships over the years, and there are good reasons why that should continue,

including economies and not subjecting parties to dual and different enforcement. There are great reasons to work closely together and we have plans to do that, but obviously the *Microsoft* experience gives us some things we need to talk about going forward.

**ANTITRUST SOURCE:** Is there any thinking being given to how the states and the Division might get back on the same page in terms of coordinating their enforcement activities in general?

**MAJORAS:** Yes, we are working on it.

**ANTITRUST SOURCE:** With the perspective you have gained from a year on the DOJ side of the table, is there any advice for private practitioners that you wish you been given when you were on that side?

**MAJORAS:** This is actually something that I was taught, but has been absolutely confirmed now that I'm on this side of the table. That is, defending your matter or your conduct by just sitting back and not offering anything affirmatively but just waiting for us to present our views and then criticizing those views without giving any alternative, is generally not very effective. It is absolutely your right to do it because we bear the burden, and we will bear the burden when we bring a case. But, it's not very helpful, particularly in the merger context, where we are being told over and over again "we need you to hurry up, we need to get this done." Investigations in which the dialogue is rich are much more efficient and effective, and very often result in no enforcement action. The gamesmanship that goes on generally doesn't get you very far except to prolong the thing. You might say "well, it really doesn't prolong the thing because I won't give you more time." But, the fact is, that we often do get more time. Nobody wants to have a lawsuit filed, so we generally get more time. Now we have reminded our staff that time is of the essence for the parties. Having said that, we do have some complicated things to investigate. So I have yet to see a situation in which the parties' gamesmanship has been helpful to them in the end. Conversely, I have seen many many cases in which professional, serious dialogue going back and forth has resulted in a very positive result on both sides.

The second thing I would say relates to third parties coming in to talk to us. We welcome those discussions with third parties. It is important that third parties be willing to come in and let us know what's going on in their market. It's very helpful and very important to us in our mission. But, two things should be kept in mind. First, keep your complaints to antitrust complaints, because otherwise you just sound like you are whining about having to compete. Second, remember that we are looking after the public interest, not just your own interest, and while there may be some overlap, they don't necessarily coincide. Third-parties need to remember that we are not bringing cases simply on their behalf. ●

## Paper Trail: Working Papers and Recent Scholarship

*This Department tracks current working papers or recently published articles of interest to antitrust practitioners and enforcers. We review four publications in this issue. The competition chapter in the 2002 Economic Report of the President seems to reinforce the comments by Dr. Katz in this issue and Dr. Scheffman in the previous issue that coordinated effects perspectives will have increased antitrust currency during the Bush years—there is nary a mention of unilateral effects. And with respect to explicit collusion in particular, the paper by Genesove and Mullin provides some interesting narrative insights into an apparently effective cartel that never set prices. Correctly or not, the paper by Brock takes antitrust enforcement during the 1990s to task for ignoring the “big picture” that resulted from M&A during that period. Finally, the Carlton and Chevalier paper addresses the prevention of free-riding via the Internet, a topic that seems especially appropriate for an online magazine.*

*As always, we welcome readers’ suggestions on papers and articles you have found to be particularly useful or insightful. Contact Editors Bill Page ([page@law.ufl.edu](mailto:page@law.ufl.edu)) or John Woodbury ([jrw@crai.com](mailto:jrw@crai.com)).*

—JRW

### Papers and Summaries

---

#### **2002 Economic Report of the President, “Realizing Gains from Competition” (Chapter 3).**

While the latest *Economic Report* does not add to antitrust scholarship, this long chapter offers a panoramic view of current antitrust issues, albeit a view that is tilted towards less government intervention. With respect to merger enforcement, the chapter lauds the advances in the Guidelines that have reduced the weight of market concentration in the analysis, allowing more play for entry and efficiencies. Perhaps, as Dr. Katz seems to have suggested in the Interview in this issue (at least with respect to his own views), the agencies will give more credence to cognizable efficiency claims than in the past. Remarkable for its absence is any discussion of the development and deployment of unilateral effects theories in the Guidelines and in agency practice. This is all the more remarkable because in an extensive description of the possible (pro- and anti-) competitive effects arising as a result of partial ownership interests (a topic whose inclusion itself is noteworthy), the underlying model is clearly one of unilateral effects (although the implicit model being used does not appear to be the usual one). What some may find as disturbing as it is surprising is its conclusion regarding the competitive risks that could arise in markets characterized by network effects. Here, Schumpeter is gospel: “[C]onclusive evidence that network effects have prevented the widespread adoption of a markedly superior product has not yet been found.” One wonders if Dr. Katz, one of the founders of modern network effects theory, would agree with such a sweeping conclusion. (Less surprising—perhaps in part in light of that conclusion—is the absence of any discussion of the ongoing *Microsoft* matter.) Consistent with a Schumpeterian view of the world, the chapter suggests that the screening process to evaluate mergers and practices in industries characterized by innovation should place far less weight on concentration than in other industries.

Other topics covered in the chapter include joint ventures, the IP-antitrust nexus, and international antitrust cooperation against the backdrop of *GE/Honeywell*.

**David Genesove and Wallace P. Mullin, “Rules, Communication, and Collusion: Narrative Evidence from the Sugar Institute Case,” NBER Working Paper 8145 (Mar. 2001)**  
[www.nber.org/papers/w8145](http://www.nber.org/papers/w8145).

In 1927, the Sugar Institute was formed to “rationalize” the behavior of sugar refiners, in response to declining margins and excess capacity, and continued in that role until a 1936 Supreme Court decision found the practices of the Institute illegal. The preceding trial laid bare the workings of the explicit cartel, particularly in the form of notes taken by one of the refiner’s executives. Taking advantage of these detailed notes, this paper compares the workings of the cartel with recent theorizing about detection and punishment. As the authors stress, what makes this cartel interesting is that it did not set prices; it set rules for pricing behavior. Thus, the rules required public postings of all prices, with requirements for when the prices could go into effect. Like other cartels (e.g., IATA), other rules specified what pricing terms were permitted to prevent secret price cuts disguised as the sale of a complementary product or service. Quantity discounts were banned, to reduce the temptation to cheat by lowering price to a large customer. Long-term contracts were banned for the same reason. Perhaps more interestingly, the cartel did not use market share changes to infer cheating, a cornerstone assumption of much of modern collusion theory. Rather, the sugar cartel instead was structured to (and apparently found it more profitable to) evaluate claims of cheating before retaliation. And retaliation did not typically occur by reversion to the non-collusive price for any detection of cheating but instead seemed to be more tit-for-tat. All in all, an interesting look into some of the problems of maintaining cartel stability.

**James W. Brock, “Antitrust, the ‘Relevant Market,’ and the Vietnamization of American Merger Policy,”**  
**46 *Antitrust Bulletin* (Winter 2001).**

In reviewing merger waves in the 1990s (largely during the Clinton administration) in the radio, retail grocery, banking, and petroleum industries, this article takes the antitrust agencies to task for an almost religious focus on narrow geographic markets. As a result, Brock claims that the antitrust agencies have overlooked the consolidation of economic power on a national scale. He examines evidence of the exercise of enhanced economic bargaining power that has resulted from these mergers, discussing, among other things, the heightened ability of national chains to bundle the sale of local advertising spots in different markets and to coordinate and control access to station playlists; the increased incidence and higher prices of slotting allowances in large grocery store chains; and the heightened ability of large ATM networks to limit access for community banks and their customers. While the article does raise an important issue—that there may be multimarket effects from a merger that must be considered—it’s hard to avoid the conclusion that this article should have been written in the 1960s. The economic and empirical analysis girding the article’s conclusions is very incomplete, lacking the necessary rigor. And its view that the agencies in the ‘90s ignored multimarket effects is (in my experience) simply wrong.

**Dennis W. Carlton and Judith A. Chevalier, “Free Riding and Sales Strategies for the Internet,”**  
**69 *J. Indus. Econ.* (Dec. 2001).**

If full-service retailers fear the information and service they provide will be used by customers to make purchases at a low-priced/low-service retail outlet, then the full-service retailers will reduce

their service level and the manufacturer will sell less product than otherwise. In response to this free-rider problem, manufacturers commonly designate exclusive sales territories or refuse to deal with price cutters, so that retailers will make a greater sales effort on the expectation that their effort will translate into sales. Carlton and Chevalier present an empirical investigation of the manner in which manufacturers have responded to the potential for Internet retail sites to free ride on sales efforts by brick-and-mortar retail outlets. For three types of branded products (fragrances, DVD players, and side-by-side refrigerators), the authors find that manufacturers appear to have adopted measures that are likely to protect sales by brick-and-mortar retailers. Manufacturer Web sites tend to charge the highest prices, and prices are also relatively high at manufacturer-authorized Web sites. Brick-and-mortar retailers also charge higher prices online than offline. ●

—JRW