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The Antitrust Modernization Commission
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Written Comments on the Antitrust Modernization Commission's
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FreedomWorks Foundation (FreedomWorks), a 360,000-member grassroots organization that promotes market-based solutions to public policy issues, is pleased to submit these comments on antitrust issues that warrant study by the Antitrust Modernization Commission (Commission). Created on July 22, 2004, by a merger between Citizens for a Sound Economy and Empower America, FreedomWorks has consistently pursued policies that foster free-enterprise and competition. FreedomWorks has been actively involved in a number of issues relating to competition and has been particularly interested in technological advances and changes in the marketplace that bolster competitive markets and consumer choice. In such instances it is critical that the legal framework adapt to the realities of the marketplace so that consumers are not unnecessarily restricted in their choices. With respect to the antitrust laws,

FreedomWorks has been concerned that the existing laws may hamper the development of new markets and innovation by banning pro-competitive practices, and therefore harm consumers by restricting competition and choice. CSE urges the Commission to use this opportunity to ensure that antitrust actions are predicated exclusively on demonstrable consumer harms.

As Harold Demsetz emphasized, competition can take many forms, and, at best, the antitrust laws seek to establish an "*efficient mixture of competitive forms* or its mirror image an *efficient mixture of monopolistic forms*."[1] Trade-offs exist between various the various forms of competition, and laws meant to address one form of competition, such as price competition, necessarily affect other forms of competition as well. Restrictions on various forms of competition will all have an impact on consumer welfare, making this a useful measure for determining whether various practices should be considered pro-competitive or anticompetitive.

The Commission, therefore, should evaluate antitrust policy based on whether or not it achieves an efficient mixture of competitive forms, rather than simply reducing monopoly. In so doing, the primary measure for any antitrust action should hinge upon consumer welfare, with policies that focus on protecting competition rather than competitors. Economic analysis, coupled with empirical findings should inform any antitrust actions that intervene in the marketplace.

With this in mind, there are several critical areas of antitrust law that may be useful to re-examine, including the following:

1. Understanding the Pro-Competitive Aspects of Tying.

While this may appear to be a simple question at first blush, a closer examination suggests that the proper definition of a product has been relevant in significant antitrust actions. After all, as demonstrated by economist Kevin Lancaster, a product is simply a collection of various characteristics that satisfy a consumer's needs.[2] Improving a product can mean enhancing those characteristics or adding new characteristics that provide more utility for the consumer. This has become particularly relevant in the new economy where high-tech products can have abbreviated life cycles and are easily modified to add new characteristics.

In recent antitrust actions, integration of new characteristics (features) to high-tech products has been challenged as a form of tying. Antitrust law has prohibited tie-in sales because they can allow firms with market power to extend their monopoly to another segment of the market. However, anti-tying rules can operate to prevent demonstrable increases in consumer welfare and actually inhibit innovation and

[1] Harold Demsetz, "How Many Cheers for Antitrust's 100 Years?" *Economic Inquiry*, Vol. XXX, April 1992, pp. 207-217.
[2] Kelvin J. Lancaster "A New Approach to Consumer Theory," *The Journal of Political Economy*, Vol. 74, No. 2, April 1966, pp.132-157.

competition. Complementarities in production or consumption suggest tying arrangements can be efficient, yet firms with any degree of market power may be reluctant to pursue these opportunities under current law, to the detriment of consumer welfare.

Clearly, applying a rule of reason rather than per se illegality to questions of tying with a multiproduct monopolist ameliorates some of these concerns. Careful analysis of both the economic efficiencies and consumer gains from tying must be considered along with any assessment of potential anticompetitive effects. To that end, we would urge the Commission to endorse a more favorable view recognizing that tying can promote innovation and improve consumer welfare; these benefits must be weighed against any evidence of anticompetitive effects before this form of competition is deemed illegal. Indeed, a modified form of per se legality, tempered by empirical evidence may be the best approach to such issues.

2. Path Dependence, Network Effects, and Lock-In

Network effects, where products increase in value as the number of people using them expands, have come to the fore as a question of competition policy in the Information Economy. Some have suggested that network effects raise new considerations for antitrust law because externalities promote anticompetitive practices such as tying and predation. As with other issues in antitrust, however, network effects can often be pro-competitive and provide increased consumer benefits. As Max Schanzenbach notes, "…network effects do not necessarily have clear cut implications for antitrust analysis, and strong affirmative defenses are possible when there is a charge of network predation."[3]

In addition, concerns have been raised about inefficient "lock-in," which constrains consumer choice to products of the dominant firm or an inferior technology path, even though superior alternatives may exist. Real-world markets, however, are very dynamic and there is little evidence of detrimental lock-in. In fact, the evidence suggests that consumers are more than willing to switch technology paths when superior products become available, as has been the case in the transition from analog to digital music formats.

The issue of network effects provides an important example of a growing tension in antitrust analysis, particularly when a rule of reason is applied. Namely, increasingly stylized theoretical economic models are being used to demonstrate the need for corrective antitrust enforcement. Yet divorced from empirical analysis, these theoretical models offer limited value for assessing real-world market competition. Sam Peltzman's assessment of the industrial organization from over ten years ago summarizes the need for caution: "It is when one confronts the substantive question—what do we know about the world now that we did not know before?—that I think skepticism about the marginal

[3] Max Schanzenbach, "Network Effects and Antitrust Law: Predation, Affirmative Defenses, and the Case of *U.S. v. Microsoft*. *Stanford Technology Law Review*, vol 4., 2002, at http://stlr.stanford.edu/STLR/Articles/02_STLR_4

value of recent theory is warranted…The main reason for my skepticism is the seeming inability of the recent theory to lead to any powerful generalization."[4] The Commission should evaluate the role played by economics in antitrust analysis and highlight those areas where economics has made the most useful contributions, as well as noting limitations associated with theoretical models.

3. What is the practical effect of multiple enforcement bodies, e.g., DOJ, FTC and States' Attorneys' General of the antitrust laws?

A number of scholars, including Richard Posner, have researched and concluded that states should not be in the business of antitrust enforcement.[5] A close examination of the *Microsoft* case strengthens the argument for federal preemption. But, if we are not willing to go that far what limits would be acceptable? It would seem reasonable that states should be preempted from all antitrust suits that are addressed by federal agencies—that is, all cases the Department of Justice or Federal Trade Commission investigates and either pursues or chooses to dismiss. At a minimum, this issue is worthy of consideration and careful deliberation.

4. International convergence and harmonization of antitrust laws.

International cooperation and, indeed, harmonization of antirust laws may make sense in certain areas, particularly in merger procedures regarding notification. However, unless countries and regions can agree on more fundamental issues, harmonization may not lead to greater efficiency and improved consumer welfare in the United States or elsewhere. In a speech at Merchant Taylor's Hall in London in 2001, E.U. Competition Commissioner Mario Monti became the first Competition Commissioner to declare that, "[T]he goal of competition policy is consumer welfare." Not a goal, but "the" goal. This is an important first step toward meaningful convergence or harmonization of U.S.-E.U. antitrust regimes. Looking forward, some issues to consider regarding harmonization or convergence have been highlighted by William Kolasky, former assistant attorney general of the Justice Department's Antitrust Division, in a speech before the United States Mission to the European Union. In that speech he highlighted five areas of divergence between U.S.-E.U. approaches to antitrust law. These include: (1) "efficiencies" in merger review; (2) fidelity rebates; (3) predatory pricing; (4) the "essential facilities" doctrine; and (5) monopoly leveraging.[6] The Commission should

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[4] Sam Peltzman, "The Handbook of Industrial Organization: A Review Article," *The Journal of Political Economy*, vol. 99, no. 1 (Feb., 1991), pp. 201-217.

[5] Richard A. Posner,; Robert B. Bell, States Should Stay Out of National Mergers, ANTITRUST, Spring 1989, at 37, 39. For a rebuttal to Posner, see Carole R. Doris, Another View on State Antitrust Enforcement--A Reply to Judge Posner, 69 ANTITRUST L.J. 345 (2001). Kevin O'Connor acknowledges the costs involved in a system with multiple antitrust enforcers, however he argues that such systems deter under-enforcement, generate more case law, therefore leading to a more rapid evolution of antitrust law. See Kevin O'Connor, Federalist Lessons for International Antitrust Convergence, 70 ANTITRUST L.J. 413, 421-22 n.46, 426 (2002).

[6] William Kolasky, U.S. Calls for Transatlantic Dialogue on Antitrust Issues, Address to the United States Mission to the European Union (May 17, 2002) (available at http://useu.be/Categories/Antitrust/May1702USEUAntitrustCooperationKolasky.html).

evaluate these harmonization efforts to ensure that consumer welfare does, indeed, drive any attempts at harmonization. In addition, the Commission should rely on the substantial antitrust research that has been conducted in the United States to promote all efficient forms of competition and incorporate pro-competitive elements into any discussions of international convergence or harmonization.

5. What are the extraterritoriality implications of U.S. antitrust laws?

Fueled by rapid advances in transportation and communications technologies, coupled with financial deregulation and lower tariffs, globalization has emerged as one of the central issues of our times. Not surprisingly globalization has also raised a number of formidable challenges and problems for the efficient application of competition law across borders. In the international context, American companies must determine if they are in danger of violating U.S. antitrust laws.

In a recent decision, *F. Hoffman-La Roche Ltd., et al v. Empagran*, et al, the Supreme Court of the United States tried to clarify when the Foreign Trade Antitrust Improvement Act of 1982 (FTAIA) does not apply to anticompetitive conduct that causes only foreign injury. In that case, the Court held that the exception to the general rule—which would be a violation of the Sherman Act—does not apply where "plaintiff's claim rests solely on independent foreign harm." This is an important issue that remains to be resolved; indeed, Congress enacted the FTAIA to clarify this issue. But, judging from *Empagran*, we should probably expect a number of cases to further clarify the definition of whether foreign anticompetitive conduct has a "direct, substantial, and reasonably foreseeable effect" on domestic commerce and when the harm is "independent." Extraterritorial application has, historically speaking, been a point of contention between the U.S. government and our trading partners, particularly in Europe. In light of broader economic consequences of cross-border antitrust enforcement, issues related to the extraterritorial reach of our antitrust laws should be carefully considered by this Commission.

The issues outlined in these comments reflect a mix of substantive and procedural concerns about antitrust enforcement. They address both our concerns about the economic impact of the antitrust laws as well as the costs associated with administering these laws. Ideally, antitrust policy should focus on consumer welfare, and policymakers should identify the least-cost method of achieving improvements in consumer welfare.

Respectfully submitted,

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