

Comments Regarding Commission Issues For Study  
Submitted to the  
Antitrust Modernization Commission  
September 30, 2004

**THE HISTORIC NEED, AND OPPORTUNITY,**  
**TO TAKE ANTITRUST TO THE NEXT LEVEL:**  
**COMPETITION BASED ON INNOVATION**  
**CREATING UNIQUE VALUE**

for  
Antitrust, the Economy, Education,  
Healthcare, and International Peace and Prosperity

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These comments draw on the forthcoming book Unique Value: Competition Based On Innovation Creating Unique Value, Charles Weller, Ed., and Michael Porter, Peter Staudhammer & Scott Stern, contributors, a book that has received comments like the following:

Ky Ewing, Chair, American Bar Association Antitrust Section 2000-2001; former Deputy Assistant Attorney General, Antitrust Division:

“UNIQUE VALUE: COMPETITION BASED ON INNOVATION CREATING UNIQUE VALUE ...is a book to be relished by thoughtful people who want to explore new dimensions of the competitive process, the very nature of which is changing as the ‘knowledge economy’ innovatively expands.”

Terry Calvani, Former Commissioner, U.S. Federal Trade Commission, Member & Director of Cartel Division, The Competition Authority of Ireland; Lecturer on Law, Trinity College, Dublin:

"[T]he work of Michael Porter" is an “antidote to the conventional welfare economics that has served as the foundation for modern competition policy for the last thirty years.”

Thomas A. Piraino, Jr., Vice President, General Counsel and Secretary, Parker-Hannifin Corporation, Cleveland, Ohio

“Michael Porter's economic analysis can revolutionize the way we think about markets and competition. Business executives, antitrust practitioners and anyone who cares about the economic organization of our society can gain valuable insights from Charles Weller's collection of some of Michael Porter's most original thinking. Mr. Weller's summaries and commentaries will be an invaluable aid to any interested reader.”

**THE HISTORIC NEED AND HISTORIC OPPORTUNITY**  
**FOR THE COMMISSION TO STUDY AND LEAD**  
**ANTITRUST TO THE NEXT LEVEL PROMPTLY**

The Commission is uniquely chartered and constituted to perform a public service of great importance and urgency -- lead the modernization of antitrust practice, policy and economics to the next level promptly. The reality is that today and increasingly in the future, unless corrected, significant elements of American antitrust policy, practice and economics undermine America's ability to compete, innovate and prosper in a global knowledge economy. In a global knowledge economy, antitrust should be like the First Amendment. Unfortunately, too often it is like the Gulag. The United States, and the world, does not have the luxury of waiting years for antitrust policy, practice and economics to move to the next level.

Fortunately, during the last 30 years or so the foundations have been laid in two areas for antitrust to advance to the next level promptly.

First, while the eyes of the antitrust world have focused on static consumer welfare efficiency economics for the last 30 years, a new, rigorous and practical theory of economics based on productivity, not efficiency, has been developed, principally by Harvard Business School Professor Michael Porter, a theory I call the Theory of Productivity, Innovation and Unique Value in the forthcoming book Unique Value: Competition Based on Innovation Creating Unique Value that I had the privilege of editing. It is a fundamentally new and different economic theory that is little known or studied in the specialized worlds of antitrust and academic economic departments, but it is now widely used worldwide elsewhere. It is also a theory, it is suggested, that provides the rigorous and practical model for analyzing dynamic competition and innovation that antitrust law has sought, in vain, for more than 100 years.<sup>1</sup> It also provides an entirely new antitrust analysis and Rule of Reason, outlined below and elaborated by Prof. Porter in Chapter 6 in Unique Value, entitled "Competition and Antitrust: A Productivity Based Approach" (Chapter 6 is attached for the Commission's convenience).

Moreover, this new theory and analysis is directly supported by, and consistent with, the second major development over the last 30 years, changes at the foundations of antitrust law by the Supreme Court, discussed next.

Second, the Supreme Court over the last 30 years has fundamentally shifted the foundations of antitrust law, particularly when viewed from a litigation perspective, both in well-known ways, and, it is suggested, in other ways yet to be widely realized and thus ideal for the Commission. The GTE Sylvania-California Dental<sup>2</sup> line of cases on per se and other presumptive rules, Brunswick<sup>3</sup> on antitrust injury, the Summary Judgment cases,<sup>4</sup> and the

<sup>1</sup> See e.g., the classic analysis by M. Handler, "The Judicial Architects of the Rule of Reason," Twenty Five Years of Antitrust 1, 30 (1973).

<sup>2</sup> Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977); Calif. Dental Assn v. FTC, 143 L. Ed 2d 935 (1999), remand, 224 F.3d 942 (9th Cir. 2000) (the Supreme Court held no "quick look" presumption could be used; on remand, the FTC lost their Rule of Reason theory; the FTC did not appeal).

<sup>3</sup> Brunswick v. Pueblo Bowl-O-Mat, 429 U.S. 277 (1977).

<sup>4</sup> Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986); Celotex Corp. v. Catrett, 477 U.S. 317 (1986); Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574 (1986); Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

Daubert Quartet<sup>5</sup> on trial experts, including Kumho and Joiner on the specific Daubert standards for the admission, and exclusion, of experts, are among the best known cases. Less well-known are the following implications and cases that provide, it is suggested, the legal foundation for a new antitrust analysis and Rule of Reason, and also render much of the adverse elements of current antitrust policy, practice and economics unenforceable in court, that is, plaintiffs like the government should lose in court like they did in California Dental.<sup>6</sup>

- California Dental, it is suggested, is a landmark ruling that (1) crystallizes the Court's 22 year effort to define the narrow circumstances that per se and any other presumptive rule can be used, including PNB,<sup>7</sup> (2) rejects much of the adverse and mechanical antitrust analysis that had developed to that date, ably described by Justice Breyer in his minority opinion, and (3) provides solid Supreme Court precedent for a new antitrust analysis and Rule of Reason based on the Theory of Productivity, Innovation and Unique Value,
- the "Daubert 6" for static consumer welfare economics experts, consisting of the Daubert Quartet plus two pre-Daubert Supreme Court precedents on a methodological flaw in economic theory dating to the 1950s ("in the real economic world rather than an economist's hypothetical model,' the latter's drastic simplifications generally must be abandoned"<sup>8</sup>),
- State Farm<sup>9</sup> on jury instructions.

Accordingly, it is suggested the Commission study, recommend, and lead critical changes that are urgently needed to take antitrust policy, practice and economics to the next level as soon as possible. Obviously careful and thorough analysis is required. Obviously there will be controversy. Obviously some of the needed changes involve a major, perhaps "revolutionary," paradigm shift, but no more than is required and supported by modern Supreme Court precedent, and no more than the last great advance in antitrust policy 30 years ago. Fortunately, most if not all of the needed changes can be made promptly, without legislation. All of which is precisely why the Commission is ideally constituted to study and lead antitrust policy, practice and economics to the next level, working with all the appropriate constituencies in Congress, the Administration, Federal, state and international agencies and governments, and otherwise, as soon as possible.

Specifically, it is suggested the Commission study and make the recommendations outlined below, and elaborated in the forthcoming book, Unique Value.

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<sup>5</sup> Daubert v. Merrell Pharmaceutical, Inc., 509 U.S. 579 (1993); General Electric Co. v. Joiner, 522 U.S. 136 (1997); Kumho Tire Co. v. Carmichael, 143 L. Ed. 2d 238 (1999); Weisgram v. Marley Co., 145 L. Ed. 2d 958 (2000).

<sup>6</sup> See C. Weller, Chap. 7, "Winning Antitrust Litigation for Defendants and Advancing Antitrust Beyond Static Economic Theory Unconventionally," in Unique Value (forthcoming) for more detail.

<sup>7</sup> U.S. v. Philadelphia National Bank, 374 U.S. 321 (1963) ("PNB").

<sup>8</sup> Illinois Brick Co. v. Illinois, 431 U.S. 720, 741-42 (1977), quoting Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481, 493 (1968).

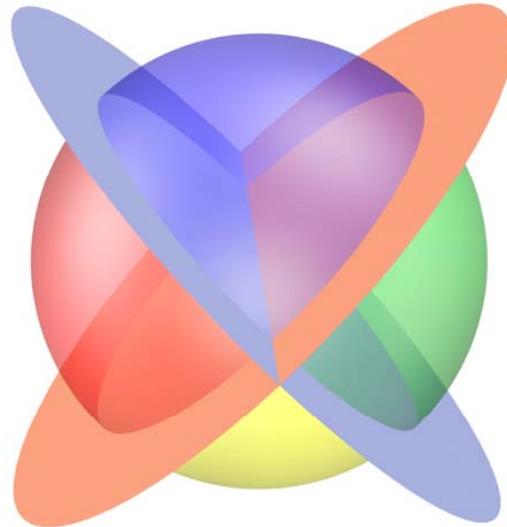
<sup>9</sup> State Farm Mutual Automobile Ins. Co. v. Campbell, 123 S. Ct. 1513 (2003). See also BMW of North America v. Gore, 517 U.S. 559 (1996).

1. Adopt the Theory of Productivity, Innovation and Unique Value as the Basis for Advancing Antitrust to the Next Level and Replacing Static Consumer Welfare Efficiency Theory
2. The New Policy Would Have Immediate Resonance in the Private Sector
3. Advocate International Antitrust Policy Advance to the Theory of Productivity, Innovation and Unique Value
4. Adopt a New Antitrust Analysis and Rule of Reason Based on the Theory of Productivity, Innovation and Unique Value
5. Update the Use of Per Se Rules and Jury Instructions to California Dental Standards
6. Update Joint Venture Law and Policy to California Dental Standards
7. Update Healthcare Law and Policy to the New Rule of Reason and California Dental Standards
8. Update Information Sharing and Trade Association Policy to the New Rule of Reason and California Dental Standards
9. Abandon the PNB Presumption as Unenforceable in the Supreme Court
10. Advocate The Theory's "Diamond" Analysis to Provide a New Vision of Government's Opportunity to Increase Prosperity
11. Advocate The Theory's "Diamond" Analysis to Provide a New Vision of Education for Innovation, Employment and Prosperity

Attachment: Unique Value (forthcoming), Chapter 6, Michael Porter, "Competition and Antitrust: A Productivity Based Approach."

**1. Adopt of the Theory of Productivity, Innovation and Unique Value as the Basis for Advancing Antitrust to the Next Level and Replacing Static Consumer Welfare Efficiency Theory**

Fig. 1-1  
Theory of Productivity, Innovation and Unique Value  
(from Unique Value (forthcoming))



<p><b>Business Environment "Diamond"</b></p> <p><b>Type of Competition</b></p> <p><b>Five Forces</b></p>
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© Michael E. Porter "Unique Value," "Five Forces," "Business Environment 'Diamond,'" "Sophistication (Type) of Competition," © 2003 Charles D. Weller graphic (with special thanks to Nottingham-Spirk Design Associates, Inc., Cleveland Ohio).

Former Chairman of the President's Council of Economic Advisor's Charles Schultze has incisively explained that "formal economic theory" emphasizes "static-efficiency," which can only produce "miniscule" increases in living standards compared to the "stimulation and harnessing of new technologies and resources" -- innovation.<sup>10</sup>

The new-to-antitrust, but widely-used elsewhere, Theory of Productivity, Innovation and Unique Value is based on productivity and innovation, rather than efficiency, and a "positive

<sup>10</sup> C. Schultze, The Public Use of Private Interest 25 (1977). Congress has also specifically found that "technological innovation" is "critical" to the "ability of the United States to raise the living standards of Americans." The National Cooperative Research and Production Act of 1993 ("NCRPA"), 15 U.S.C. secs. 4301-05.

sum" form of competition, for advanced economies like the United States and around the world. Some of the features of this rigorous and practical theory are outlined next.

### **Three New Variables**

The Theory of Productivity, Innovation and Unique Value uses three key variables, shown in Figure 1-1, to analyze the dynamic and interactive connections needed to maximize productivity growth and the standard of living:

<u>Variable</u>	<u>Graphic</u>
Business Environment "Diamond"	Globe
Type (Sophistication) of Competition	Blue circle
Five Forces	Red circle

The **Business Environment "Diamond"** surrounds all of the various economic actors at the geographic level being analyzed, such as a country, city, state, region or grouping of countries, like the European Union. The Business Environment "Diamond" variable is the "globe" in Figure 1-1, with its four facets in four colors.

The **blue** circle is the Type of Competition variable.

The **red** circle is the Five Forces variable.

The three variables are applied to any relevant geographic level, from city and inner city, to state, region, nation and beyond; to an industry and its segments in each of its geographic markets; and outwards from the perspective of any economic actor, including a country, state or region; industry or cluster, or individual firm.

Economic actors include not only buyers, suppliers, competitors, companies, industries, segments and clusters, but also universities, schools, research institutions, and government, as well as smaller geographic areas like cities within states within countries.

When any of the three variables are applied to one of these economic actors, it is like taking a sample or cross-sectional slice, like a "biopsy."

### **Knowledge Not a Limited Resource**

"[K]nowledge," Peter Drucker explains, has become "the primary resource for individuals and for the economy overall."<sup>11</sup> "Since a babe was born in a manger, it may be doubted whether so great a thing has happened with so little stir," borrowing Alfred North Whitehead's wonderful description of the birth of modern reasoning in the 1600s.<sup>12</sup> People and ideas, not plants, equipment, and natural resources, have become the primary resource for the economy.

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<sup>11</sup> "Talking About Tomorrow: Peter Drucker," Wall St. J. (Jan.1, 2000)("economics makes three assumptions that are no longer tenable ... One is that the national economy is a unit of activity in which monetary and tax policy determines the behavior of both individuals and businesses. Secondly is the scarcity axiom. The third one is that if you sell something you alienate it, you have lost it. None of these is valid anymore.")

<sup>12</sup> A. Whitehead, Science and the Modern World 3 (1925; Free Press 1967).

The implications of a knowledge economy for antitrust and generally are difficult to overstate. Among them, knowledge is an unlimited, not a fixed, resource. This means that “the scarcity axiom” of static consumer welfare efficiency economics is not valid.

Most importantly, this means that the Theory of Productivity, Innovation and Unique Value is factually supported by one of the newest, still emerging and most important facts of our times, if not all time -- the knowledge economy.

### **Wealth Unlimited**

With knowledge as the primary source of wealth, and unlimited, “a radical shift from previous conceptions of the sources of wealth” is required, from the assumption that wealth is fixed and that cheap natural resources, cheap labor and efficiency are determinative to a new reality where “the potential for wealth is limitless” because wealth “is based on ideas and insights, not fixed because of scarce resources.”<sup>13</sup> Unlike the “zero sum” competition of static consumer welfare efficiency theory, this new Theory provides a “positive sum” focus for competitive analysis.

### **Competing Over Efficiency "Dangerously Incomplete"**

Under the Theory, efficiency is not sufficient to maintain, let alone grow, prosperity for all, because global competition places increasing pressure on prices when the same products and practices are involved. Operational effectiveness is important, but best practices diffuse rapidly throughout the world, so that they are not sufficient. Indeed, under the Theory, when all competitors imitate each other by adopting the same best practices, the same improvements in quality, the same cycle time, the same manufacturing processes and the same suppliers, they become alike and commoditize the business. Prices and wages fall. Thus, contrary to the conventional wisdom, “competing on total quality and continuous improvement — on doing the same thing as rivals but doing it better” is “dangerously incomplete,” often leading to “chronically low profitability,” as Japan’s experience since the mid 1980’s empirically and dramatically demonstrates.<sup>14</sup>

### **High Wages and High Profits**

The Theory of Productivity, Innovation and Unique Value expressly focuses on the need for high profits to support high wages and continuous innovation. “The central question in respect to profits,” Peter Drucker explains, “is whether they are high enough to allow the economy to take the risks it needs to take in order to grow.”

Under the Theory of Productivity, Innovation and Unique Value, in stark contrast to short-term consumer welfare efficiency theory, profit is not to be minimized, profit is essential for innovation, high wages, capital investment and long-term consumer welfare. Under the antitrust laws, high profits and even monopoly prices alone, are lawful. Monopoly alone is not illegal under the Sherman Act. What is illegal is monopolization, so that monopoly power to raise prices above competitive levels is always lawful when the monopoly was obtained by

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<sup>13</sup> M. Porter, Chap. 2, Unique Value (forthcoming).

<sup>14</sup> Id.

“superior skill, foresight, and industry” U.S. v. Aluminum Co. of America, 148 F.2d 416, 430 (2d Cir. 1945)(J. Learned Hand).

Thus, static consumer welfare efficiency theory is actually in conflict with the antitrust laws in key respects regarding profits and pricing, a conflict the Theory of Productivity, Innovation and Unique Value resolves in support of innovation that increases productivity and prosperity.

### **Innovation Economies**

In the resulting "Innovation Economies," innovative products and services at the global technology frontier creating unique value are the dominant sources of competitive advantage. Companies compete with unique strategies that are often global in scope.

A real life example, the author's favorite, is the SpinBrush toothbrush, at last count the largest selling manual or electric toothbrush in the world. SpinBrush did not exist five years ago. It was developed, produced and marketed by four Clevelanders in a start-up company with \$1.5 million in financing, then sold to Procter & Gamble three years later for \$475 million.<sup>15</sup> The Spinbrush is manufactured in China, sold for about \$5, would not exist without the this American-Chinese collaboration, and the vast majority of the revenue generated provides jobs and income in the U.S.<sup>16</sup>

### **Widespread Use**

As noted, the Theory of Productivity, Innovation and Unique Value is already widely used worldwide outside antitrust and static consumer welfare economics, including the following:<sup>17</sup>

#### **U.S., State and Local U.S. Economic Prosperity**

- U.S. and 101 other countries in 2003, Chap. 4, Unique Value (forthcoming); *Global Competitiveness Report 2003-04*.
- "Ranking National Innovative Capacity: Findings from the National Innovative Capacity Index," Chap. 5, Unique Value (forthcoming); *Global Competitiveness Report 2003-04*.
- Porter & Stern, "The Impact of Location on Innovation: Findings from the National Innovation Capacity Index," *Global Competitiveness Report 2002-03*
- Porter & Stern, "National Innovative Capacity," *Global Competitiveness Report 2001-2002*;
- Porter & Stern, *The New Challenge to America's Prosperity* (1999); [www.weforum.org](http://www.weforum.org); [www.oup-usa.org](http://www.oup-usa.org); [www.compete.org/Publications/](http://www.compete.org/Publications/)
- Porter & van Opstal, *U.S. Competitiveness 2001*, [www.compete.org/publications/](http://www.compete.org/publications/)
- Porter, Ketels, Miller & Bryden, "Competitiveness in Rural U.S. Regions" (Feb. 2004),
- *Clusters of Innovation National Report*, Porter et al. (2001); [www.nga.gov](http://www.nga.gov); [www.compete.org](http://www.compete.org)
- *Clusters of Innovation Initiative: Atlanta-Columbus Georgia* (2002)

<sup>15</sup> M. Porter, Chap. 2, Unique Value (forthcoming).

<sup>16</sup> C. Weller, Chap. 1, "Connections," Unique Value (forthcoming).

<sup>17</sup> See Prof. Porter's Institute for Strategy and Competitiveness website, [www.isc.hbs.edu](http://www.isc.hbs.edu), and other citations in Unique Value.

- *Clusters of Innovation Initiative: Pittsburgh* (2002)
- *Clusters of Innovation Initiative: Research Triangle* (2002)
- *Clusters of Innovation Initiative: San Diego* (2001)
- *Clusters of Innovation Initiative: Wichita* (2002)
- Connecticut
- Massachusetts
- Mississippi

### **International Economic Prosperity**

- 102 countries in 2003, Chap. 4; Unique Value (forthcoming), *Global Competitiveness Report 2003-04*.
- Argentina
- Australia
- Balkan Rim
- Basque
- Canada
- China
- Europe – see also, Ketels, "Why the European Context Matters" (2002).
- Greece
- Japan – see also, Porter et al, *Can Japan Compete?* (2000).
- Latin American Center for Competitiveness and Sustainable Development (CLACDS) <http://dor.hbs.edu/>
- Malaysia
- Netherlands
- New Zealand
- Portugal
- Singapore
- South Africa
- Sweden
- Taiwan
- Thailand
- United Arab Emirates
- U. K.
- Wales

### **Inner City Economic Prosperity**

- "Inner City Renewal," Harvard Business School Global Alumni Conference, Cleveland, Ohio, May 2001; [www.isc.hbs.edu](http://www.isc.hbs.edu)
- M. Porter, "The Competitive Advantage of the Inner City," *On Competition* (1998); [www.isc.hbs.edu](http://www.isc.hbs.edu)

### **Environmental Policy**

- "Green and Competitive: Ending the Stalemate" (with Claas van der Linde), On Competition (1998).
- D. Esty & Porter, M., "Ranking National Environmental Regulation and Performance: A Leading Indicator of Future Competitiveness?," *Global Competitiveness Report 2001-2002* at 78.

### **Philanthropic Organizations**

- Porter & Kramer, "The Competitive Advantage of Corporate Philanthropy," *Harvard Bus. Rev.* (Dec. 2002); <http://www.effectivephilanthropy.org/>
- Porter & Kramer, "Philanthropy's New Agenda: Creating Value," *Harvard Bus. Rev.* (Nov. 1999); <http://www.effectivephilanthropy.org/>

Unique Value (forthcoming) has five chapters by Prof. Porter and nine chapters overall.

### **PART 1 -- NEW FOUNDATIONS: PRODUCTIVITY, INNOVATION AND UNIQUE VALUE**

Chap. 1: Connections, *Charles D. Weller*

Chap. 2: Overview, *Michael E. Porter*

Chap 3: Microeconomics of Productivity and Innovation, *Michael E. Porter*

Chap 4: Building the Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index 2004, *Michael E. Porter*

Chap 5: Ranking National Innovative Capacity: Findings from the National Innovative Capacity Index 2004, *Michael E. Porter, Scott Stern*

### **PART 2 -- COMPETITION AND ANTITRUST**

Chap. 6: Competition and Antitrust: A Productivity-Based Approach, *Michael E. Porter*

Chap. 7: Winning Antitrust Litigation for Defendants and Advancing Antitrust Beyond Static Economic Theory Unconventionally, *Charles D. Weller*

### **PART 3 -- MATH-SCIENCE AND "META" EDUCATION**

Chap. 8: "Meta" Education for Productivity, Innovation and Employment, *Peter Staudhammer, Charles D. Weller*

### **PART 4 -- HEALTHCARE**

Chap. 9: Science Teams by Disease When Ill , *Charles D. Weller*

In addition, there are several special sources of information relevant to these comments and the Commission's task that it is suggested the Commission hear from by teleconference, in person and otherwise:

1. Peter Drucker (now in his mid-90s). See, e.g., Drucker, P., *The Age of Discontinuity* (1968; 1992), and *Innovation and Entrepreneurship* (1985).

2. Michael Porter, including his Internet Course available next spring, "The Microeconomics of Competitiveness." See [ww.isc.hbs.edu](http://www.isc.hbs.edu)

3. Clayton Christensen, Harvard Business School. See, e.g., The Innovator's Dilemma (1997), Christensen & Raynor, The Innovator's Solution (2003), and Christensen, Anthony & Roth, Seeing What's Next (2004).

4. Mark Blaug, University of London. See C. Weller, Chap. 7, "Winning Antitrust Litigation for Defendants and Advancing Antitrust Beyond Static Economic Theory Unconventionally," in Unique Value; Blaug, "Disturbing Currents in Modern Economics" and "The Problems With Formalism: Interview with Mark Blaug," 41:3 *Challenge* II, 35 (1998); M. Blaug, *The Methodology of Economics* (1980).

## **2. The New Policy Would Have Immediate Resonance in the Private Sector**

The reality is that today's antitrust policy is a foreign language to most business people, from HHIs, to high profits being problematic and a variety of other arcane and specialized concepts. On the other hand, as noted, Five Forces and other elements of the Theory of Productivity, Innovation and Unique Value are very well known in the business community, and an antitrust policy based on it would be quickly understood.

## **3. Advocate International Antitrust Policy Advance to the Theory of Productivity, Innovation and Unique Value**

Since 1980, antitrust law has changed dramatically from being essentially an American phenomenon to the law in more than 100 countries.<sup>18</sup> However, there is no uniformity in either the substance or procedure of antitrust in all these countries around the world. As a substantive policy matter, economic efficiency theory has been adopted as policy in the United States and in a number of countries over the last twenty years, but price theory is only one of at least seven. Even though the need to harmonize antitrust policy worldwide is widely recognized, convergence remains illusive.

From this international perspective, the Theory of Productivity, Innovation and Unique Value, it is suggested, has extraordinary value, first, for the worldwide search for a sound basis for antitrust policy, and second, for international peace and prosperity, for the reasons covered next.

### **Unique Civilizations, Unique Value, International Prosperity and International Antitrust,**

Alfred North Whitehead has wonderfully observed that "nations of different habits are not enemies; they are godsend" because "diversification among human communities" provides the "material for the Odyssey of the human spirit."<sup>19</sup>

Under the Theory of Productivity, Innovation and Unique Value, "instead of isolating some peoples in their economic disadvantage," unique "cultural differences can contribute the specialized advantages so important to improving the prosperity of nations in the global economy" as "unique aspects of a society" provide the basis for "new patterns of international

<sup>18</sup> There are "over 80 antitrust regimes in the world and another two dozen in the making." Cowell, "Seeking a Common Rule Book for International Mergers," N.Y. Times BU-4 (Jan. 1, 2001).

<sup>19</sup> C. Weller, Chap. 1, "Connections," Unique Value (forthcoming).

specialization” and “nations increasingly produce those goods and services in which their culture gives them a unique advantage.”<sup>20</sup>

Thus with the Theory of Productivity, Innovation and Unique Value and its focus on unique value, differences among unique civilizations are preserved, celebrated and strengthened, not lost, subjugated or homogenized. “Globalization will not eradicate culture, as some have feared,” but, to the contrary, “cultural differences” can and should “become more celebrated.” *Id.*

It thus promotes not only a rising standard of living economically for all, it promotes real international understanding, and thus addresses two of the root causes of terrorism. It thus also provides a much needed new basis for international antitrust policy.

#### **4. Adopt a New Antitrust Analysis and Rule of Reason Based on the Theory of Productivity, Innovation and Unique Value**

The Theory of Productivity, Innovation and Unique Value provides a new antitrust and Rule of Reason analysis, based on productivity growth rather than static efficiency, using three new variables (see Fig. 1-1). This fundamentally new analysis is elaborated in Prof. Porter’s Chapter 6 from the book Unique Value (attached) and the author’s Chapter 1.

But make no mistake. The Theory of Productivity, Innovation and Unique Value is fundamentally new and different in numerous ways. Productivity replaces efficiency, and standard of living and long-term consumer welfare replace short-term consumer welfare as primary goals; it does not use concentration theory, HHIs, profitability, price increases and other tools of current antitrust analysis to determine the legal issue of whether or not a substantial lessening of competition is likely; it eliminates the need to determine the relevant market; it uses three key variables that are measurable, understandable and rigorous: Five Forces, Diamond analysis of the business environment, and the Type (Sophistication) of Competition.

#### **Single "Relevant Market" Determination Unnecessary**

The relevant market issue dramatically highlights the difference between current antitrust analysis and the Theory of Productivity, Innovation and Unique Value. Today the relevant market, rather than whether there is a substantial lessening of competition, is, as a practical matter, often the decisive antitrust issue. “Market definition” is of “overwhelming importance in antitrust cases,” MIT economics professor Franklin Fisher correctly observes, even though it is an “artificial construction created by antitrust litigation.”<sup>21</sup>

Market definition is an artificial construction created by antitrust litigation. For any other purpose of economic analysis, the binary question ... is a meaningless one. ... Such activity, however, has historically been of overwhelming importance in antitrust cases.

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<sup>20</sup> M. Porter, Chap. 2, Unique Value (forthcoming).

<sup>21</sup> F. Fisher, Industrial Organization, Economics and the Law 37 (1991).

The Theory of Productivity, Innovation and Unique Value ends this "artificial construction," and solves the relevant market problem in antitrust by focus on the analysis of competition itself in each market segment.

Indeed, Five Forces analysis solved a similar relevant market problem in another discipline, Mr. Porter's field of business management, for similar reasons, twenty years ago:<sup>22</sup>

[Five Forces] Structural analysis, by focusing broadly on competition well beyond existing rivals, should reduce the need for debates on where to draw industry boundaries. Any definition of an industry is essentially a choice of where to draw the line between established competitors and substitute products, between existing firms and potential entrants, and between existing firms and suppliers and buyers. Drawing these lines is inherently a matter of degree that has little to do with the choice of strategy [or the antitrust analysis of competition].

If these broad sources of competition are recognized, however, and their relative impact assessed, then where the lines are actually drawn becomes more or less irrelevant to strategy formulation [or the antitrust analysis of competition]. Latent sources of competition will not be overlooked, nor will key dimensions of competition.

In the colorful words of Nobel Laureate George Stigler, "the typical antitrust case is an almost impudent exercise in economic gerrymandering." The Theory of Productivity, Innovation and Unique Value avoids this problem by analyzing every plausible relevant market, rather than basing its analysis on a dubious foundation, the relevant market.<sup>23</sup>

Further, two Supreme Court precedents directly support this new method of antitrust analysis, California Dental and Cracking Oil, using three variables to analyze "positive sum" competition directly and understandably.

The California Dental majority has, in effect, rotated antitrust analysis 180° back to where it was always supposed to be, on competition rather than surrogates for competition. Antitrust for decades has not been able to analyze competition directly, and, instead, has analyzed surrogates and other issues like "concentration ratios," "HHIs," "consumer welfare," "the power to raise price or exclude competition," "common control," "integration," "risk sharing," "market power" and "monopoly power." No more. The Theory analyzes competition itself.

The second Supreme Court precedent worthy of note uses an analysis strikingly similar to Prof. Porter's three variable analysis. In 1931, Justice Brandeis' in Cracking Oil used a multi-dimensional analysis of competition itself. This analysis, Prof. Handler explained, did not focus

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<sup>22</sup> Porter, Competitive Strategy at 32.

<sup>23</sup> Justice Brandeis' 1931 Cracking Oil analysis, his last Rule of Reason opinion, was similarly multidimensional, examining the same issue, competition, from different perspectives at the same time, rather than proceeding linearly and being wholly dependent on a questionable foundation, the relevant market. Std. Oil of Indiana v. U.S., 283 U.S. 163 (1931)("Cracking Oil"). See generally Weller, Chap. 7, Unique Value

on the "fact that a combination eliminates competition inter sese," but focused instead on whether "the quality of competition in the market as a whole remains unimpaired."<sup>24</sup> In effect, Mr. Brandeis' Cracking Oil analysis asks "who cares" about the internal operations of a combination, even if they involve price agreements by competitors? Under his analysis, the type of restraint in the abstract is of limited analytical value because it is disconnected from, and has no reliable link to, competition overall (except cartels or other "naked" restraints).

Thus, there is Supreme Court precedent directly supporting a new antitrust Rule of Reason analysis using the Theory.

## 5. Update the Use of Per Se Rules and Jury Instructions to California Dental Standards

More than a half century ago, Justice Douglas wrote U. S. v. Socony-Vacuum Oil Co., affirming the criminal conviction of 12 corporations and 5 individuals, using language that is still widely-used to define per se illegal price-fixing: viz, a "combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing ... price" is "illegal per se"<sup>25</sup> is language still commonly found in jury instructions and in price-fixing theories asserted by government and private plaintiffs in complaints, at trial and elsewhere. Jury instruction on per se price-fixing still commonly use this now classic language from Socony Vacuum about agreements "to fix, control, raise, lower, maintain or stabilize price:"<sup>26</sup>

Under the Sherman Act it is illegal for two or more competitors to enter into an agreement to fix, control, raise, lower, maintain or stabilize the prices charged or to be charged for products or services. This prohibition is violated not only if the same price is set by competitors, but also if the range or level of prices is agreed upon or various price formulas are agreed upon.

The Supreme Court, however, since GTE Sylvania in 1977 has overruled and otherwise sharply narrowed the availability of per se and other presumptive theories repeatedly. California Dental it is suggested now provides the standard that is controlling. The Supreme Court rejected the FTC's attempted use of a "quick look" presumption theory. The case involved a price restraint by a dental association, but the five member majority held that it was "far from intuitively obvious" there were "any anticompetitive effects"<sup>27</sup> and that the FTC's "quick look" presumption theory could not be used.

The Court held that a "quick look" presumption and arguendo, all presumptions, can only be used when the "likelihood of anticompetitive effects" are "intuitively obvious," when there are no "plausible" explanations of neutral or procompetitive effects,<sup>28</sup> and that any claim of anticompetitive effects by plaintiffs must be based on sound theoretical and factual evidence because "assumption alone will not do."<sup>29</sup>

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<sup>24</sup> M. Handler, "The Judicial Architects of the Rule of Reason," Twenty Five Years of Antitrust 1, 30 (1973).

<sup>25</sup> 310 U.S. at 223.

<sup>26</sup> ABA, Sample Jury Instructions in Civil Cases B-16 (1999).

<sup>27</sup> 143 L. Ed 2d at 944 (emphasis added).

<sup>28</sup> *Id.* at 944, 956.

<sup>29</sup> *Id.* at 953-54 n.12.

These standards from the landmark Supreme Court California Dental decision should be controlling in jury instructions, and in the use of per se rules and all presumptions, including PNB. They also solve many of the problems in antitrust today, discussed next.

## **6. Update Joint Venture Law and Policy to the New Rule of Reason and California Dental Standards**

Today, Peter Drucker points out, the "legal entity, the company, is a reality for shareholders, for creditors, for employees, and for tax collectors" -- and antitrust -- but "economically, it is fiction."<sup>30</sup> Yet, indeed for over 100 years, antitrust joint venture policy and law has been a morass of confusion and ambiguity. "[I]ncoherence and inconsistency" is how Gellhorn and Miller describe the "case law and enforcement policies applied to joint ventures," including the perverse result that "joint ventures receive a more hostile reception in the agencies and courts" than mergers.<sup>31</sup> A "mystery shrouded in a riddle wrapped in an enigma," in the words of another antitrust commentator, borrowed from Winston Churchill.<sup>32</sup>

Although the Supreme Court has repeatedly emphasized that the "economic, legal, or other considerations that lead corporate management to choose one structure over the other" is not the issue, the issue is "whether the enterprise's conduct seriously threatens competition,"<sup>33</sup> the antitrust reality is that legal form matters a great deal. Legal form can be the difference between going to jail as a price-fixer, and having no antitrust exposure at all, depending on whether or not entities are ruled to be under "common control."<sup>34</sup>

Under California Dental standards for per se and other presumptions and the New Rule of Reason, legal form is re-attached to the ultimate issue, competition, so that the issues of whether there is a joint venture or merger, its duration, its non-competes over products and people, are not analyzed by themselves, but for their effect on the competitive process overall. Joint venture law and policy would advance to the next level.

## **7. Update Healthcare Law and Policy to the New Rule of Reason and California Dental Standards**

In June of this year, Michael Porter and Elizabeth Teisberg published "Redefining Competition in Healthcare," *Harvard Business Review* 65 (June 2004), what I suggest, having spent more than 30 years in the field, is the most important new thinking in healthcare in 70 years (third party payment or "health insurance" as a practical matter dates to the 1930s). I had the privilege of working with them on the article, and applied some of their ideas and some of

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<sup>30</sup> See generally Unique Value; "Symposium: New Foundations for the Joint Ventures and Antitrust," 44 Antitrust Bulletin 785-1078 (1999) (C. Weller, Guest Editor.)

<sup>31</sup> Gellhorn & Miller, "Competitor Collaboration Guidelines -- A Recommendation," 42 Antitrust Bulletin 851, 854 (1997). See also, In re Brunswick Corp., 94 F.T.C. 1253, 1265-66 (Pitofsky, Commissioner 1979), aff'd in relevant part sub nom. Yamaha Motor Co., Ltd. v. FTC., 657 F.2d 971 (8th Cir. 1981), cert. denied, 456 U.S. 915 (1982).

<sup>32</sup> November 2, 1984 J. Paul McGrath remarks, 18th Annual New England Antitrust Conference, 5 CCH Trade Reg. Rep. ? 50,470, at 56,137.

<sup>33</sup> Copperweld, 467 U.S. 752, 772 (footnote omitted and emphasis added).

<sup>34</sup> Copperweld itself ended decades of litigation over "intra-corporate" conspiracies, but left often protracted analysis and litigation over "control."

my own to the world I practice and work in to write "Science Teams By Disease When Ill," Chapter 9 of Unique Value. Alain C. Enthoven, Mariner S. Eccles Professor of Public and Private Management Graduate School of Business, Stanford University has written:

“With ‘Science Teams By Disease When Ill,’ Chuck Weller is truly propounding a Copernican revolution for healthcare. This new model has doctors, hospital personnel and others in the care process working together to improve quality and efficiency across institutional and professional boundaries. It is new and obviously raises many new questions, but it makes possible clear accountability of teams for quality and outcomes, something that doesn’t exist or barely exists today.”

“This is very important and greatly needed.”

The problem is that current antitrust practice and policy on joint ventures, per se rules, jury instructions and guidelines too often are based on outdated antitrust precedent and health care policy premised on capitation and other old ideas, the net result of which is that antitrust unnecessarily slows down and even blocks, rather than encourages and facilitates, the very innovation in healthcare the country so desperately needs. This serious problem can be promptly solved by updating healthcare law and policy to the New Rule of Reason and California Dental standards.

## **8. Update Information Sharing and Trade Association Policy and Law to the New Rule of Reason and California Dental Standards**

Today's antitrust law, fundamentally forged in an industrial age, is often counterproductive in a knowledge economy. Information sharing among competitors in the antitrust world today is often viewed as a step away from horizontal price-fixing, if not closer. "American antitrust laws toward trade associations," Mr. Porter observes, "have been especially counterproductive and have contributed to the ineffectiveness of most associations in enhancing national advantage."<sup>35</sup>

Under the new antitrust analysis and using California Dental standards, information sharing by competitors is rotated virtually 180°, for reasons Justice Brandeis so ably stated almost eighty years ago. "Surely it is not against the public interest to distribute knowledge of trade facts, however detailed," Justice Brandeis wrote, because "[i]ntelligent conduct of business implies, not only knowledge of trade facts, but an understanding of them:"<sup>36</sup>

By substituting knowledge for ignorance, rumor, guess, and suspicion, it tends also to substitute research and reasoning for gambling and piracy, without closing the door to adventure, or lessening the value of prophetic wisdom. ... The evidence in this case, far from establishing an illegal restraint of trade, presents, in my opinion, an instance of commendable effort by concerns

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<sup>35</sup> M. Porter, The Competitive Advantage of Nations 664 (1990).

<sup>36</sup> American Column & Lumber v. U.S., 257 U.S. 377, 416, 418 (1921) (J. Brandeis, dissent). His views were adopted by the majority four years later. Maple Flooring Mfrs. Assn. v. U.S., 268 U.S. 563 (1925).

engaged in a chaotic industry to make possible its intelligent conduct under competitive conditions.

Current antitrust law, unfortunately, substitutes ignorance for knowledge, and thus is particularly counterproductive to the knowledge economy of the present. The New Rule of Reason analysis of competition and California Dental standards can end this analytical anachronism for antitrust.

## 9. Abandon the PNB Presumption as Unenforceable in the Supreme Court

The Daubert Quartet's mandate that expert evidence be reliable or be excluded at trial, and the economic literature after PNB in 1963, seem certain to doom the PNB<sup>37</sup> presumption in joint venture and merger litigation in the Supreme Court.<sup>38</sup>

For example, as to the economic literature, Judge Posner points out in a 1994 opinion that "it is many years since anyone knowledgeable about antitrust policy thought that concentration by itself imported a diminution in competition."<sup>39</sup> He also explained how his views on concentration had changed 180° from Von's Grocery, which he supported at the time because he then "accepted the oligopoly theory of economists Joe Bain and Edward Chamberlin," but then explained that later "empirical studies about profits as a function of concentration" undermined concentration theory and he now concludes that "the Von's merger was completely harmless."<sup>40</sup>

Similarly, Judges Easterbrook and Posner summarized studies that undermine the PNB concentration presumption in the 1984 Supplement to their antitrust text:<sup>41</sup>

These new studies call into question the position -- which underlies much of antitrust law ... that increasing concentration creates a significant risk of cartels (or cartel-like oligopolistic interdependence).

Professor Bain's work, of course, is the seminal work underlying the 1963 PNB presumption. Professors Scherer and Ross in their 1990 text state that we now know that Bain's work at the foundation of the PNB presumption was "almost surely spurious:"<sup>42</sup>

[R]ecent work has demonstrated that most, if not all, of the correlation between profitability and concentration found by Bain and his descendants (at least for the United States) was almost surely spurious -- the result of aggregating a positive relationship

<sup>37</sup> U.S. v. Philadelphia National Bank, 374 U.S. 321 (1963) ("PNB").

<sup>38</sup> See C. Weller, Chap. 7, "Winning Antitrust Litigation for Defendants and Advancing Antitrust Beyond Static Economic Theory Unconventionally," in Unique Value for more detail.

<sup>39</sup> Capital Cities/ABC, Inc. v. F.C.C., 29 F.3d 309, 315 (7th Cir. 1994).

<sup>40</sup> "From Von's to Schwinn to the Chicago School: Interview with Judge Richard Posner, Seventh Circuit Court of Appeals," ABA, Antitrust 4, 5 (Spring 1992).

<sup>41</sup> R. Posner & F. Easterbrook, Antitrust Cases, Economic Notes and Other Materials 41-43 (2d ed. Supp. 1984).

<sup>42</sup> F. Scherer & D. Ross, Industrial Market Structure and Economic Performance 411 (3d ed. 1990).

between sellers' market shares and profitability to the industry level.

Most recently, Harris and Smith in 1999 published an extensive review of both the "theoretical and empirical economics literature that addresses these issues." They concluded, *inter alia*, that "[m]uch of the empirical literature suffers from fundamental problems (e.g., the failure to define antitrust markets) that cause their results to be unreliable," and that the "empirical literature does not indicate the existence of any unique critical concentration level, including the 1,800 HHI level used in the [Merger] Guidelines."<sup>43</sup>

Without citing Daubert or PNB specifically, the Supreme Court majority in California Dental showed how readily Daubert would apply to the PNB presumption, making clear that "before a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of procompetitive effects," a court must consider both "the theoretical basis for the anticompetitive effects" and "whether the effects actually are anticompetitive."<sup>44</sup> The PNB presumption, of course, like the "quick look" presumption, is a "theoretical claim of anticompetitive effects" that "shift[s]" to a defendant "the burden" to show "procompetitive effects." Given the economic research after 1963, when a judge at a Daubert hearing asks the plaintiff to put on their expert to testify regarding the PNB presumption, it seems unlikely the economist or any other expert can meet the "reliability" test to be used at trial. Moreover, even if admitted at trial, it is subject to challenge on appeal as an abuse of discretion by the trial court, since, as Justice Scalia's colorfully underscored in his concurring opinion in Kumho, admitting "expertise that is *fausse* and science that is junky" is an abuse of discretion.<sup>45</sup>

## **10. Advocate The Theory's "Diamond" Analysis to Provide a New Vision of Government's Opportunity to Increase Prosperity**

Since FDR and the 1930s, there have been basically two views of the role of government: liberal and conservative. Former Chairman of the President's Council of Economic Advisers Charles Schultze incisively described the liberal view, that whenever "social problems arise because of distorted private incentives," government's role is seen to try to "specify in minute detail the particular actions that generate social efficiency and then command their performance," "without remedying the incentive structure," but "equally consistently, the power of that structure defeats us" because in "complex areas of human behavior, neither our imagination nor our commands are up to the task."<sup>46</sup> The conservative view is, basically, the less government, the better.

The Theory's "Diamond" analysis is neither, defining a necessary and fundamentally new vision of government's role linked to increasing productivity and prosperity:

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<sup>43</sup> "The Merger Guidelines v. Economics: A Survey of Economic Studies," Antitrust Report 23, 24-25 (Sept. 1999).

<sup>44</sup> 143 L. Ed 2d at 953-54 n.12.

<sup>45</sup> Kumho, *supra*, at 256-57.

<sup>46</sup> C. Schultze, *The Public Use of Private Interest* 65 (1977). See also S. Breyer, Regulation and Its Reform (1982).

## 'Diamond' Analysis of New Role for Government

### #1: Demand Conditions

- Create streamlined, pro-innovation regulatory standards affecting the cluster
- Reduce regulatory uncertainty
- Stimulate early adoption of new products and technologies
- Encourage upgrading
- Sponsor independent testing, product certification, and rating services for cluster products/services
- Act as sophisticated buyer of the cluster's products/services

### #2: Factor (Input) Conditions

- Create specialized education and training programs
- Establish local university research efforts in cluster-related technologies
- Support cluster-specific information gathering and compilation
- Enhance specialized transportation, communications, and other infrastructure

### #3: Context for Firm Strategy and Rivalry

- Eliminate barriers to local competition
- Organize relevant government departments around clusters
- Focus efforts to attract foreign investment around clusters
- Focus export promotion around clusters

### #4: Related and Supporting Industries

- Sponsor forums to bring together cluster participants
- Mount cluster-specific efforts to attract suppliers and service providers from other locations
- Establish cluster-oriented free trade zones, industrial parks, or supplier parks

## **11. Advocate The Theory's "Diamond" Analysis to Provide a New Vision of Education for Innovation, Employment and Prosperity**

The “Diamond” variable in the Theory connects education to employment and careers in the Innovation Economy, referred to in Unique Value as “meta” education. This “Diamond” provides new solutions and hope for the nation's math-science literacy and educational performance problems, for employment in the inner city and for workers who have lost or may lose their manufacturing and other jobs, as well as for all. Connecting education to the Innovation Economy provides the “missing link” that makes “the type of education sought and what the education is used to accomplish” likely to be focused in new ways that will be successful. It is also likely to make education in Peter Drucker's opinion the "number one growth industry in the next thirty years."

Most importantly, connecting education to an Innovation Economy and Innovation – “meta” education – will create, Peter Drucker concludes, new “choices for the individual” that can enable each person to do “almost anything one wants to do and plying almost any knowledge.” See Chap. 8 in Unique Value (front page attached).

**Chapter 8:**

**"META" EDUCATION**  
**FOR PRODUCTIVITY, INNOVATION AND EMPLOYMENT**

**Peter Staudhammer**  
**Charles D. Weller**



**Co-Author Peter Staudhammer with  
Jim Lovell and the Rocket Engine  
Used to Rescue Apollo 13 and  
Land Neil Armstrong on the Moon**

**Cleveland Museum of Natural History  
January 2002**