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ON BEHALF OF
THE UNITED STATES DEPARTMENT OF JUSTICE

ANTITRUST MODERNIZATION COMMISSION
HEARING ON ANTITRUST AND THE NEW ECONOMY

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I. Introduction

The Antitrust Division is pleased to participate in the Antitrust Modernization Commission hearings addressing antitrust analysis in "new economy" industries where innovation, intellectual property, and technological change are pervasive.

The federal antitrust laws have been around for over 100 years, during which time, they have repeatedly demonstrated the flexibility and resiliency necessary to deal effectively with rapid, and sometimes dramatic, changes in the American economy. They have served the American public well, from the Industrial Age, into the Information Age, and right up to the present. They are flexible enough to work in industries that are constantly evolving through the introduction of new technology that alters the products and services available to consumers and the identity of present and likely future competitors.

A former Assistant Attorney General of the Antitrust Division pointed out that "when it comes to antitrust enforcement, the new, new thing isn't so new after all."[1] "[T]he illegitimate means of getting and keeping market power have changed little since Senator Sherman's day," and the core principles of antitrust reflected in the Sherman Act "state enduring rules that can and should be applied in new

[1] Joel I. Klein, Assistant Attorney General, *Rethinking Antitrust Policies For The New Economy*, Address Before the Haas/Berkeley New Economy Forum (May 9, 2000), *available at* http://www.usdoj.gov/atr/public/speeches/4707.pdf, at 14.

situations."[2]

The antitrust laws, with the exception of *per se* violations such as price fixing and market and customer allocation, require that we evaluate conduct and mergers in light of the particular characteristics of the industry involved and the nature of competition. Because this involves a fact-based analysis, undertaken by applying recognized economic principles, antitrust enforcers are able to deal with industries that are experiencing fast-paced changes, and therefore serve the underlying goal of preserving and protecting competition in rapidly evolving markets.

It is against this backdrop that the Division responds to the three issues the Commission has raised about new economy antitrust analysis, namely (1) whether there should be a presumption of market power in tying cases when there is a patent or copyright, (2) whether the two-year time horizon used in the Horizontal Merger Guidelines to assess the timeliness of entry should be adjusted in certain circumstances, and (3) whether the antitrust laws should be concerned with "innovation markets."[3]

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[2] *Id*. at 1-2.

[3] Antitrust Modernization Commission, Request for Public Comment, 70 Fed. Reg. 28906 (2005).

II. Presumption of Market Power in Patent and Copyright Tying Cases

As the Department of Justice recently indicated in its Supreme Court amicus brief in *Illinois Tool Works Inc. v. Independent Ink, Inc.*,[4] there should not be a presumption of market power in tying cases when there is a patent. Nor is there any theoretical or empirical basis for presuming that sellers of copyrighted products have market power within the meaning of the Sherman Act.

The *Independent Ink* amicus brief explains why "[t]here is no economic basis for inferring market power from the mere fact that the defendant holds a patent."[5] While the existence of a patent certainly can be relevant to the question of market power, only a small percentage of patents actually confer significant market power. That is because a "patent grant creates an antitrust 'monopoly' only if it succeeds in giving . . . the exclusive right to make something for which there are no adequate market alternatives, and for which consumers would be willing to pay a monopoly price."[6]

Those relatively rare instances where a patent actually confers significant

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[4] Brief for the United States as Amicus Curiae Supporting Petitioners, *Illinois Tool Works Inc. v. Independent Ink, Inc.* (No. 04-1329), *cert. granted*, 73 U.S.L.W. 3729 (June 21, 2005), *available at* http://www.usdoj.gov/atr/cases/f210500/210544.pdf [hereinafter Amicus Brief].

[5] Amicus Brief at 5.

[6] 1 Herbert Hovenkamp et al., *IP and Antitrust* § 4.2, at 4-9 (2002).

market power cannot support a sweeping presumption of market power whenever the tying product is patented. A market participant's possession of a patent right, and the consequent statutory right to exclude infringing products from the marketplace, cannot give the participant market power if – as is usually the case – there are noninfringing alternatives to the patented product that economically qualify as good substitutes. Our amicus brief in *Independent Ink* lists several examples such as toothbrushes, bottle openers, and paper clips where "[i]t would be implausible to presume that the owner of such a patent possesses market power merely by virtue of the patent."[7]

Courts consequently should make a careful inquiry into the realities of the relevant market, regardless of whether the tying product is patented, before invoking the rule of *per se* illegality. The same is true with regard to copyrights.

III. **Horizontal Mergers Guidelines' Two-Year Time Horizon**

With regard to the appropriate time frame for assessing the timeliness of entry, the Division utilizes the two-year period specified in Section 3.2 of the Merger Guidelines.[8] However, as Section 3.2 suggests, there is some flexibility

[7] Amicus Brief at 12 (footnote omitted).

[8] U.S. Dep't of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* (with Apr. 8, 1997 revisions to Section 4 on efficiencies) § 3.2, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶

about when the two year clock starts.[9] For example, if prices are locked in under long-term contracts or no new sales are likely to be made in the immediate future, entry occurring beyond two years might nonetheless effectively deter or counteract the adverse competitive effects of the proposed merger, and we have been and are willing to consider this in appropriate cases.

The Commission has questioned whether the two-year horizon in the Merger Guidelines should be adjusted to include newly developed products that may erode market power beyond the two-year period. It is important to recognize that the Merger Guidelines set forth time periods only for entry[10] and market delineation.[11] They do not establish a two-year horizon for examining competitive effects.

The Division certainly has considered expected effects -- both positive and negative -- more than two years into the future in its merger analysis, particularly in matters involving the development of innovative, next-generation products. The

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13,104 ("The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact.").

[9] *Id.* ("Where the relevant product is a durable good, consumers, in response to a significant commitment to entry, may defer purchases by making additional investments to extend the useful life of previously purchased goods and in this way deter or counteract for a time the competitive effects of concern. In these circumstances, if entry only can occur outside of the two-year period, the Agency will consider entry to be timely so long as it would deter or counteract the competitive effects of concern within the two-year period and subsequently.").

[10] *Id.* § 3.2.

[11] *Id.* §§ 1.321-1.322.

Division's challenge of the proposed Lockheed Martin-Northrup Grumman merger is a good example.[12] In that case, the Division alleged that the merger would substantially lessen competition both in the present and future development, production, and sale of high-level defense electronics and combat aircraft. In several of the product markets, bidding on the contracts would have been outside the two-year horizon.[13]

The Commission has also questioned whether there is a length of time for which possession of market power does not present antitrust concerns. As a general rule, very short-lived market power should not be an antitrust concern when reviewing mergers. While there is no bright-line test for when the period goes beyond "very short," it should be long enough to result in serious consumer harm – i.e., where consumers are paying higher prices, or receiving poorer quality, for more than a brief, transitory period. On the other hand, the Division likely would bring suit where the possible harm is potentially large and the period of harm is less than two years. Even a relatively short period of anticompetitive effects could be sufficient to present an antitrust concern.

The Division is skeptical that new economy industries warrant different

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[12] Complaint, *United States v. Lockheed Martin Corp.*, (D.D.C. Mar. 23, 1998), *available at* http://www.usdoj.gov/atr/cases/f1600/1609.htm.

[13] *Id.*

merger enforcement treatment than other industries. All merger enforcement is predictive, regardless of whether "new" or "old" industries are involved in the merger. Each merger investigation must be decided based on its own facts and circumstances.

IV. "Innovation-Markets" Analysis

The third issue the Commission raised for this hearing is the appropriateness of utilizing "innovation markets" in merger analysis. The agencies care about the effects a merger has on innovation. Indeed, the Merger Guidelines specifically state that sellers with market power may lessen competition on dimensions such as innovation. However, that analysis is typically done in a traditional goods or products market. Separately defining an innovation market, that is a market for research and development, is only necessary if a merger may affect innovation that cannot be adequately addressed through the analysis of goods or technology markets.

Using an innovation market analysis in analyzing a horizontal merger is potentially useful but requires caution. Indeed, while the Division has undertaken innovation market analysis in a small number of mergers, the Division has never challenged a prospective merger solely on that basis. To date, the Division has filed only one case alleging harm in an innovation market.[14]

The Department of Justice and Federal Trade Commission Merger Workshop in 2004 included a panel focused on this specific topic.[15] Although it was generally agreed that innovation markets could be helpful in merger analysis, the presentations and discussions identified certain reasons for enforcers to be cautious in utilizing innovation markets analysis in merger cases.

One reason identified for caution is that innovation markets analysis presents significant predictive challenges. It is not always easy to predict accurately the competitive effects of a merger on products that already exist. Predicting accurately the effects of a merger on the development of products that do not — and may never — exist is even more difficult.

A second concern discussed is the ability to identify other potential sources of innovation. We may know from the merging companies documents that these

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[14] The only Division merger challenge alleging an innovation market was the 1993 challenge to ZF Friedrichshafen's proposed acquisition of General Motors' Allison Division. GM and ZF were the main worldwide producers of automatic transmissions for buses and large trucks. In addition to challenging the deal on the basis of injury to current competition in two product markets, the Division also alleged that the transaction would harm the worldwide innovation market for improvements in automatic transmissions for commercial and military vehicles. The complaint alleged that United States consumers would be injured by the loss of innovation competition even as to product applications where ZF had been neither a present nor prospective United States seller if the merger were consummated.

[15] *See* U.S. Dep't of Justice & Federal Trade Comm'n Merger Workshop Transcript, *Nonprice Competition/Innovation* (February 18, 2004), *available at* http://www.usdoj.gov/atr/public/workshops/docs/203842.pdf

two firms are engaged in research and development efforts designed to lead to innovation in a particular area. But, the question then becomes whether all other sources of potential innovation been identified. That is, can we predict that no one in his garage (or firm in their research and development lab) is inventing a product that could be competitive with what these two firms may ultimately produce. The Department will delineate an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms.

Thus, it was suggested that using a separate innovation markets analysis should be used rarely, where the transaction has competitive effects on innovation that cannot be adequately addressed otherwise. In those rare cases, the enforcer needs to be in a position accurately to predict the transaction's innovation effects. Some have pointed to pharmaceuticals as the prime candidate for applying this analysis, because there may be particularly good information about the research and development pipeline due to the FDA approval process.

V. Conclusion

The Division appreciates this opportunity to comment upon these important issues.