Notes for Talk at conference at NYU School of Law
“One Year Later: The Antitrust Modernization Commission’s Report and the Challenges That Await Antitrust”

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I come with bad news. Whatever the outcome of the Chicago vs. post-Chicago school debate, the future effectiveness of antitrust policy as a constraint on exclusionary practices by dominant firms is bleak. The complaisance of the Commission’s report is, I fear, misplaced, in part because its emphasis on standards that “should be clear and predictable in application and administrable” provides dominant firms with opportunities to exclude based on market muscle rather than mere efficiency.

As I understand it, I am to put forward a few ideas to stimulate discussion -- targets to shoot at. Here they are, all subject to change as the discussion develops.

Let me suggest four topics for your consideration.

TOPIC 1: THE RELIANCE ON A COST TEST OF PREDATION LOADS THE DICE IN FAVOR OF PREDATING DOMINANT FIRMS.

The Modernization Report cites the area of predatory pricing law as "the best example of success" in achieving the goals of clarity and predictability. (p.89.) Why? Because "In *Brooke Group* the Supreme Court established an objective, cost-based test that first requires a predatory pricing plaintiff to prove that the alleged predatory prices are below an appropriate measure of the defendant's costs." Leave aside for the moment that the Oxford English Dictionary defines "objective" as "existing as an object of consciousness as opposed to having a real existence," which might be a good description of the concept of "cost" as understood by lawyers. Leave aside, too, the claim of success for a policy based on something called "appropriate" cost tests; in this day and age standards of propriety vary with the beholder.

Finally, leave aside the charming assumption that not only can costs of a single product be determined, but that it is possible

to determine the "incremental cost for the competitive product" that is part of a bundle. (p.99.)

Consider instead the economic reality in the market place, even if that reality is not sufficiently "clear and predictable and administrable" to win the plaudits of the Modernization Report. (Only strict *per se* rules can meet that test, and I have met few businessmen who favor that route to certainty.) The hard fact is that an entrenched incumbent, charging monopoly prices, can lower those prices quite a lot without reducing them below some concept of cost. Such reductions would be a signal not only to potential entrants, but to the venture capitalists who increasingly finance these entrants, of what might be in store for them if they challenge the incumbent. And such price cuts might prove to be every bit as transient as reductions that take prices below some measure of cost. And, in the long run, rewarding to the dominant firm even if recoupment as that term is generally understood cannot be proved.

It seems to me not unreasonable to worry that the Commission's fear of deterring the price competition that we hope new entry will produce, has led it to ignore the possibility that such entry will not occur if a dominant firm is allowed to signal its intent to crush any newcomer by offering a small taste of the price wars to come. And price wars that leave prices somewhat above any

“objective” measure of cost are as entry-deterring as those that take prices below some such elastic measure. So I think it is worth considering whether predation is possible (or would the lawyers call this more accurately monopolizing behavior?) when prices are lowered to a level above any measure of cost.

Leave aside the question of the difficulty of determining whether the prices with which an incumbent chooses to confront a newcomer exceed some concept of marginal, or incremental, or average variable cost; assume they do. Assume even that they exceed average total cost. As Peggy Lee once asked in a different connection, “Is that all there is, my friend?”

I think not: an examination of the entire range of competitive practices of the incumbent over time, not each one of those practices in isolation, seems to me to provide a better basis for deciding whether or not we are dealing with predation, or with attempts to raise rivals’ costs by depriving them of an opportunity to achieve economies of scale. Intelligent analysis of the market in question, not bean-counting cost calculations, is required.

Certainly a judicial tribunal that considers itself competent to decide which of the competing measures of cost presented to it by learned economists (and, worse still, by accountants whose concepts of cost are as devoid of economic content as their audits often are of any meaning) is the “relevant measure” and is

accurate, is capable of employing all of the evidence unearthed in multi-million discoveries to reach a judgment as to whether a price cut is predatory or not, without being bound by a rigid cost test.

TOPIC 2: THE DANGERS OF OVER-DETERRENCE AND UNDER-DETERRENCE ARE NOT SYMETRICAL.

The Commission wants to “minimize overdeterrence and underterrence, both of which impair consumer welfare.” (p.82.) That statement is unexceptionable, but application of a policy that sees over-deterrence and under-deterrence as equal dangers will serve the interests of dominant firms engaging in exclusionary behavior.

True, we should avoid chilling pro-competitive behavior. True, too, juries, the object of jokes by over-educated economists whose analytical skills outstrip their expository skills, tend to be sympathetic with the “little guy” when he argues that some big bully is trying to put him out of business. But there is always a risk that cases will be wrongly decided, even by judges, much less the much-maligned juries, often accused of being unable to make sense of economists’ testimony that is so convoluted that it would, in the words of Tevye in “Fiddler on the Roof”, “cross a Rabbi’s eyes”. And no doubt there is also an ever-present risk that later scholarship will reveal a decision to have been wrongly decided.

The question we have to ask ourselves is whether a wrongly-decided case that penalizes pro-competitive behavior is a greater threat to the free market system than is a wrongly-decided case that allows a potential competitor to be nipped in its incipiency, if I might borrow a phrase used in another connection.

TOPIC 3: IT IS SOMEWHERE BETWEEN DIFFICULT AND IMPOSSIBLE TO FRAME REMEDIES WHEN A DOMINANT FIRM HAS BEEN FOUND TO ENGAGE IN EXCLUSIONARY BEHAVIOR.

The EC has found that after long drawn-out litigation massive fines can curb some existing exclusionary practices, but not certainly deter new variants of the old game. The difficulty of going beyond fines to frame behavioral relief is that such relief requires on-going judicial review of price changes and other practices of a company, especially those specializing in the creation of intellectual property, or involved in industries in which technology is changing rapidly. Behavioral relief is not really available for two reasons.

First, we do not want to slow the pace of innovation to accommodate the more leisurely one of the judicial process. Experience with Judge Green's supervision of the telecommunications industry is reason enough for caution.

Second, it is not at all certain that the courts can cope with firms understandably reluctant to comply promptly with their orders, witness the recent confession of the judge in the Microsoft case that the remedies she had ordered are not working terribly well,[1] or the frustration of the EU competition authorities as they attempted to develop and enforce a behavioral remedy for the anticompetitive tactics deployed by Microsoft. Divestiture and structural solutions playing a larger role relative to the prohibition of specific practices, if we are serious about curbing exclusionary practices.

## 4. THE MODERNIZATION COMMISSION FAILS TO RECOGNIZE THAT THE ROLE OF VENTURE CAPITALISTS IN FUNDING NEW ENTRANTS HEIGHTENS THE EFFECTIVENESS OF THREATENED OR ACTUAL EXCLUSIONARY BEHAVIOR.

The Commission fails to recognize the extent to which venture capitalists play a key role in financing new entrants, especially in the increasingly important high-tech industries to which we look for advances in productivity. These capitalists, the first port of call for a newcomer after he has exhausted his own and his family's resources, are notably hard-headed realists. If

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

they suspect that an entrenched incumbent will be allowed to snuff out incipient competition by inducing manufacturers to boycott the new product, or by using technological legerdemain to tie its own competing product to its monopoly product, or by setting a pricing schedule that in effect results in bundling or full-line forcing, venture capitalists will, at the very least, raise the cost of capital to reflect the enhanced risk, (this is the really important "C" in RRC -- raising rivals' cost) and more likely suggest to the newcomer that completion of his doctoral dissertation or a job with the entrenched incumbent is his best option. They must always be satisfied, before opening their wallets, that the incumbent does not have sufficient market power to nip the competition in its incipiency by deploying practices related solely to its size and power. In order to part with their capital VCs must know that antitrust policy precludes incumbents from threatening potential suppliers with retaliation if they do business with the newcomer; or warning distributors of the unpleasant consequences of dealing with the new entrant; or permitting the dominant incumbent to manipulate its multi-product price schedule so as to make it uneconomic for its customers to divert part of their custom to the potential new entrant. Only with the assurance that the law protects their investment from being washed away by such tactics that have nothing to do with the relative merits of the competing

products, will venture capitalists write the checks the challenger needs.

These realists know what some academic analysts do not: experience suggests that dominant firms are willing to have recourse to tactics that are related to their market power, rather than merely to their efficiency. The use of these tactics turns the battle into one in which the firm with greater market power wins, rather than the firm with the best mousetrap.

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It seems not unreasonably churlish to read the Modernization Commission Report as failing to recognize the danger exclusionary practices pose to the openness of our economy and, by extension, our society.

I trust that provides a sufficient set of targets for people cheerier than I about the likely future effectiveness of the antitrust laws in deterring exclusionary behavior. I would add to that grim appraisal the notion that it is increasingly difficult to prove “dominance”, but that is a subject for another panel.