Federal Trade Commission

Promoting Innovation: Just How "Dynamic" Should Antitrust Law Be?

Remarks of J. Thomas Rosch*
Commissioner, Federal Trade Commission

before the

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My task for today is to give you some insight into the ways that conduct involving patents can raise antitrust concerns. I could talk for hours on this topic if for no other reason than the state of law governing single-firm conduct – i.e. conduct by firms with monopoly power – is in a state of flux. So rather than provide you with a recitation of Antitrust 101 during your lunch hour, I thought I would leave that responsibility for my panel following lunch and instead set the stage for the afternoon by addressing some important big picture ideas relating to the antitrust/IP interface. First, to what extent do antitrust and intellectual property share the same objectives? Second, to what extent has Section 2 of the Sherman Act served those objectives? And, third, to the extent Section 2

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* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Amanda Reeves, for her invaluable assistance preparing this paper.

has failed to serve those objectives, under what circumstances should Section 5 of the Federal Trade Commission Act pick up the slack?

I.

If you were to get together a group of antitrust and patent experts, everyone would likely agree broadly that antitrust and intellectual property are complementary in that both areas of law seek to protect and encourage innovation. When it comes to antitrust law, however, promoting innovation is good in theory, but hard in practice.

The problem is that antitrust has historically largely applied a static analysis based on neoclassical economics, which mostly looks at marginal prices and costs in the short run. The goal under a static approach is to avoid transactions or practices that have the effect of increasing prices or reducing output, either of which will reduce short-term consumer welfare. Firms that have some degree of pricing power (prices exceeding the marginal cost of production) are said to have market power and are typically subject to greater antitrust scrutiny than other firms.

In contrast, dynamic analysis focuses on the long-run considerations that capture the goals associated with innovation, including, among other things, the creation of new products and services. The person most closely associated with this approach is economist Joseph Schumpeter, who emphasized that a certain amount of protection from competition is necessary for a firm to undergo the risks and costs of innovating and that innovation can have a great effect on consumer welfare.[1] A number of studies have confirmed his insight that technological progress may benefit consumers to a greater

[1] Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 2100 (3d ed. 2007 supp. 2009) (citing Joseph Schumpeter, *Capitalism, Socialism and Democracy* (1942)).

degree than the elimination of noncompetitive prices.[2] The goal under the dynamic approach is to examine how a transaction or practice will affect innovation over time.

Proper antitrust enforcement considers both static and dynamic effects and efficiencies. In its seminal opinion in *United States v. General Dynamics Corporation,*[3] the Supreme Court recognized that static analysis, standing alone, would not suffice in analyzing merger cases that involved markets that were not static. That is true of many, if not most, markets today in which producers of computer components or software are the participants. Those markets are dynamic. As the Court indicated, in assessing whether current concentration and market shares are likely to be prologue for any substantial period of time it is appropriate to look at the market's history – at trends, stability over time, entry and repositioning, as well as other indicia that things are likely to change, such as whether and to what extent venture capital is flowing to market participants.[4]

Nevertheless, antitrust enforcement has historically focused more on static than dynamic analysis. I believe that is true for a number of reasons. First, the antitrust community – both lawyers and economists – has far greater familiarity and comfort with

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[2] *See, e.g.*, Frederic M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 613-85 (3d ed. 1990); Robert M. Solow, *Technical Change and the Aggregate Production Function*, 39 Rev. Econ. & Stat. 312 (1957); Robert M. Solow, *A Contribution to the Theory of Economic Growth*, 70 Q.J. Econ. 65 (1956). *See generally* Michael A. Carrier, *Unraveling the Patent-Antitrust Paradox*, 150 U. Pa. L. Rev. 761, 813 (2002) ("The consensus among economists since Schumpeter is that the gains achieved from innovative efficiencies dwarf those derived from maximizing allocative efficiency and that innovation is the most important factor in the growth of the economy.").

[3] 415 U.S. 486 (1974).

[4] *Id*. at 506; *see also Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 276-77 (7th Cir. 1981); *United States v. Int'l Harvester Co.*, 564 F.2d 769, 777-801 (7th Cir. 1977).

static analysis than dynamic analysis. Second, there is little incentive for parties to take the time to develop arguments premised on dynamic analysis, given the courts' and antitrust agencies' focus on static analysis. Third, there's the perception – right or wrong – that dynamic analysis is less well developed and less measurable than static analysis.[5] Indeed, as one scholar has noted:

> [The] problem [is that] . . . static price analysis appears to be so precise. It gives this illusion of a precise quantifiable answer that you can see on a graph. But there's just no way that you can easily put quality, innovation, and consumer choice on that graph. Even when you try to have a balance between these two things, our natural bias is to give more weight to the thing that looks measurable.[6]

Complicating matters further is the fact that, while antitrust lawyers can agree that a dynamic (or long-run) analysis is necessary to protect innovation, there remains the important substantive debate as to what incentives firms need in the first place to innovate. Are firms better off with monopoly power? Or with competition? Or is it the case that firms need both – the opportunity to acquire monopoly power coupled with vigorous competition along the way – to work towards innovation?

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[5] For example, it is not clear that greater concentration impedes optimal dynamic performance. *See* Fed. Trade Comm'n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* Ch. 2 at 12-15 (2003) [hereinafter FTC Innovation Report] ("Statistical cross-section studies examining multiple industries have not identified any clear relationship between concentration and innovation."); *see also* Statement of Chairman Timothy J. Muris, Genzyme Corporation / Novazyme Pharmaceuticals, Inc., FTC File No. 021 0026 (Jan. 13, 2004), *available at* http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf ("[N]either economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation (and hence patient welfare) based simply on observing how the merger changed the number of independent R&D programs. Rather, one must examine whether the merged firm was likely to have a reduced incentive to invest in R&D, and also whether it was likely to have the ability to conduct R&D more successfully.").

[6] Roundtable, *The Role of a Consumer Harm Test in Competition Policy*, 20 Loy. Consumer L. Rev. 151, 153 (2008) (Remarks of Christopher Leslie). Another problem is that there is no consensus as to how to weigh static and dynamic efficiencies when they point in different directions.

In this regard, it is noteworthy that, in the patent context, the constitutional framers appear to have punted on this question. As the Supreme Court explained in *Bonito Boats*, the Constitution's "Patent Clause reflects a balance between the need to encourage innovation and the avoidance of monopolies which stifle competition . . . ."[7] By all accounts, that assessment is correct. On the one hand, the patent system provides a number of incentives for research and innovation – and thus dynamic welfare gains – by helping inventors capitalize on the value of their inventions.[8] Patents provide aspiring patent holders benefits to strive for. In addition to years of exclusivity rights, patent holders are accorded certain advantages in litigation – such as the presumption of validity[9] – and the broad right to license or transfer their patent rights to others. On the other hand, however, providing patent rights can also be inefficient. The grant of a legal monopoly to an inventor harms consumer welfare insofar as the inventor is be able to charge a higher price or reduce output, both of which are detrimental to consumers and result in what economists call a deadweight loss. In addition, a patent holder may spend significant resources obtaining and protecting his intellectual property, and the threat of infringement litigation – whether legitimate or baseless – can act as a barrier to entry by potential competitors.[10] These are also detrimental to consumer welfare.

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[7] *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989).

[8] U.S. Const. art. I, § 8, cl. 8; (granting Congress the authority to establish a system of patents and copyrights to "promote the Progress of Science and useful Arts"); *Graham v. John Deere Co.*, 383 U.S. 1, 8-9 (1966) (describing a patent as "a reward, an inducement, to bring forth new knowledge").

[9] 35 U.S.C. § 282 ("A patent shall be presumed valid.").

[10] FTC Innovation Report, *supra* note 7, at Ch. 2 p. 8 ("Patentee suits against entrants for infringement can 'tax' entry. The threat of being sued for infringement by an incumbent

These static costs may be justified when the promise of a patent helps motivate the investment in (or disclosure of) an invention. But bestowing patents on inventions that would have occurred (or would have been disclosed) without the promise of patent protection results in a windfall to the inventor and higher prices to consumers. Put another way, patenting an invention that would have occurred and been disclosed, absent the inducement of a patent, is unambiguously detrimental because there is a static consumer loss and no dynamic efficiencies.[11]

In theory, an optimal level of patent protection should strike a balance between the static and dynamic considerations. Researchers have tried to determine whether Congress and the courts have made these tradeoffs correctly,[12] but significant debate remains about even the fundamental question of whether patents are needed to stimulate innovation. Several studies have found that firms prefer a variety of appropriability mechanisms, such as secrecy and lead time over competitors, to patent protection. An early and relatively small study of 100 firms concluded that patents were essential for innovation in only two of twelve industries: pharmaceuticals and chemicals.[13] A subsequent study of 650 firms found that patents were rated last out of five strategies for

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– even on a meritless claim – may 'scare . . . away' venture capital financing."), and at Ch. 2 p. 11 ("Amassing patent portfolios . . . is, as one commenter noted, a 'rather costly arms race.' It generates a 'lot of resource waste,' some panelists noted since firms spend 'a significant amount on legal bills to apply for patents . . . .'").

[11] *KSR International Co. v. Teleflex, Inc*., 550 U.S. 398, 419 (2007) ("Granting patent protection to advances that would occur in the ordinary course without real innovation retards progress.").

[12] For example, there is considerable debate as to the optimal duration and scope of intellectual property rights. *See, e.g.*, Richard Gilbert & Carl Shapiro, *Optimal Patent Length and Breadth*, 21 Rand J. Econ. 106 (1990); Paul Klemperer, *How Broad Should the Scope of Patent Protection Be?*, 21 Rand. J. Econ. 113 (1990).

[13] Edwin Mansfield, *Patents and Innovation: An Empirical Study*, 32, Mgmt. Science 173 (1986).

protecting new processes, and fourth for protecting new products.[14] The same study found considerable variation by industry, with patents more useful for protecting pharmaceuticals and certain chemicals.[15] A third study found that firms protect profits from invention primarily through secrecy and lead time, with patent protection the least important strategy [16] The study concluded that "patents are unambiguously the least central of the major appropriability mechanisms overall."[17] Like the other studies, this one found that the importance of patents varied by industry, with medical equipment and pharmaceuticals standing out at the high end and semiconductors and communications equipment at the low end.[18]

A few years ago, the ABA Section of Antitrust Law reviewed the empirical studies and concluded that patents are an important inducement to innovation in only a few industries and that expanding the rights provided by an existing patent system does not increase overall inventive activity.[19] The ABA report found that patents helped stimulate R&D in the pharmaceutical industry but not in some high-tech industries where "the advantages that come with a head start, including setting up production, sales, and service structures and moving down the learning curve, were judged much more effective

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[14] Richard C. Levin et al., *Appropriating the Returns from Industrial R&D*, Brookings Papers on Economic Activity 783, 794-95 (1987). The five ways of protecting new processes and products in the survey were lead time, learning curve advantages, complementary sales or service advantages, secrecy, and patents.

[15] *Id*.

[16] Wesley M. Cohen, Richard R. Nelson & John P. Walsh, *Protecting Their Intellectual Assets: Appropriability Conditions and Why U.S. Manufacturing Firms Patent (or Not)* (Nat'l Bureau of Econ. Research Working Paper No. 7552, 2000).

[17] *Id*. at 9.

[18] *Id*. Table 1.

[19] ABA Section of Antitrust Law, *The Economics of Innovation: A Survey* § II.E. (2002).

than patents as an inducement to R&D."[20] Several other surveys of the empirical data have also concluded that there is little or no link between the degree of patent protection and innovation in many industries.[21]

The challenge, then, for decision-makers in antitrust cases from an antitrust perspective is to develop rules within the current common law framework that both reflect a dynamic, long-term view, but which incentivize innovation.

II.

Most of what you have been told about antitrust law invariably relates to Section 2 of the Sherman Act, which, generally speaking, prohibits exclusionary conduct by a firm with monopoly power.[22] As I have remarked elsewhere, the growth in Chicago

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[20] *Id*. For a contrary view, see Yi Qian, *Do National Patent Laws Stimulate Domestic Innovation in a Global Patenting Environment? A Cross Country Analysis of Pharmaceutical Patent Protection, 1978-2002*, 89 Rev. Econ. & Statistics 436 (2007) (concluding that patent protection does not stimulate pharmaceutical innovation).

[21] *See, e.g,*. FTC Innovation Report, *supra* note 7, Ch. 2(II)(A)(2), at 11 (2003) ("Empirical study has shown that in some industries, firms often innovate to exploit first-mover advantages, learning-curve advantages, and other advantages, not to gain patent protection."); *see also id.* ch. 2(I)(A)(1), at 5 ("[A] number of studies have shown that [other] measures typically are more important than patents for protecting appropriability in many industries."); Cohen, *supra* note 19, at 2 (stating that prior studies "suggest that patent protection is important in only a few industries, most notably pharmaceuticals"); Adam B. Jaffe, *The U.S. Patent System in Transition: Policy Innovation and the Innovation Process*, 29 Research Policy 531, 540, 554 (2000) (noting that there is "little empirical evidence" that strengthening patent protection in the 1980s increased innovation and that several studies suggest "that patents are not central to appropriating the returns to R&D in most industries"); Michele Boldrin & David K. Levine, *Does Intellectual Monopoly Help Innovation?* 13 (Working Paper 2009) ("We have identified twenty three economic studies that have examined the issue empirically. The executive summary: they find weak or no evidence that strengthening patent regimes increases innovation; they find strong evidence that strengthening the patent regime increases patenting!").

[22] *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (distinguishing unlawful conduct from "growth or development as a consequence of a superior product, business acumen, or historic accident").

School and post-Chicago School economic thinking over the last thirty years and the application of the Chicago School's teachings to antitrust law has caused a decided shift in how courts decide cases.[23] Nowhere is this shift more pronounced than in the Section 2 common law. Perhaps foremost among those changes has been the emphasis on whether a rule or holding will foster or inhibit efficiencies as reflected in pricing. Indeed, although there remains a debate about whether there should be a single Section 2 doctrinal test to govern all instances of alleged anticompetitive single-firm conduct, many of the major tests proposed thus far – the "profit sacrifice" test and the "no economic sense" test[24] – focus exclusively on static efficiencies.

The shift in Section 2 law towards focusing on predicted efficiencies and prices – to the exclusion of less easily quantifiable non-price harms and the long-term harm occasioned by a dominant firm's entrenchment – has meant that the Section 2 common law has had very little to say doctrinally about how to value, weigh, or otherwise assess dynamic efficiencies, such as innovation and improvements to quality and choice. In the Section 2 context, the Supreme Court in *Aspen Skiing* and the D.C. Circuit in *Microsoft*

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[23] *See, e.g.*, J. Thomas Rosch, "Antitrust Enforcement: What to Do About the Current Economics Cacophony?" Remarks at the Bates White Antitrust Conference, Washington, D.C. (June 1, 2009), *available at* http://www.ftc.gov/speeches/rosch/090601bateswhite.pdf; J. Thomas Rosch, "Implications of the Financial Meltdown for the FTC," Remarks at New York Bar Association Annual Dinner, New York, NY (Jan. 29, 2009), *available at* http://www.ftc.gov/speeches/rosch/090129financialcrisisnybarspeech.pdf; J. Thomas Rosch, "The Common Law of Section 2: Is it Still Alive and Well?" Remarks at George Mason Law Review 11th Annual Antitrust Symposium, Washington, D.C. (Oct. 31, 2007), *available at* http://www.ftc.gov/speeches/rosch/071031gmlr.pdf.

[24] *See, e.g.*, Gregory Werden, Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test, 73 Antitrust L.J. 413 (2006); Gregory Werden, The "No Economic Sense" Test for Exclusionary Conduct, 31 J. CORP. L. 293 (2006); A. Douglas Melamed, Exclusive Dealing Agreements and Other Exclusionary Conduct—are There Unifying Principles, 73 Antitrust L.J.375 (2006) (arguing that *Aspen Skiing* "explicitly embraced" the profit-sacrifice test).

arguably came the closest to adopting a paradigm that could account for such dynamic efficiencies. In both cases, the courts examined not only the effect of the defendant's actions, but whether the defendant had an intent to cripple a rival who could constrain the defendant's exercise of its monopoly power.[25] An examination of the defendant's intent at the very least permits the consideration of evidence that could (as it did in *Microsoft*) show harm to something other than price.

And then of course there is Justice Scalia's decision in the *Trinko* case, which arguably is the most direct attempt to account for dynamic concerns.[26] There, Justice Scalia suggested that those who enforce the antitrust laws ought to be deferential to firms with monopoly power, which he characterized as "an important element of a free market system."[27] The reason for that, he said, is that the opportunity to acquire monopoly power and charge monopoly prices is "what attracts 'business acumen' in the first place" and "induces risk taking that produces innovation and economic growth."[28] So, in

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[25] *See, e.g.*, *United States v. Microsoft Corp.*, 253 F.3d 34, 59, 76 (D.C. Cir. 2001) (en banc) (observing "[e]vidence of the intent behind the conduct of a monopolist is relevant . . . to the extent it helps us understand the likely effect of the monopolist's conduct" and finding that documents authored by senior executives, which showed that "Microsoft's ultimate objective" was to thwart Java's threat to Microsoft's monopoly power in the market for operating systems were probative of Microsoft's liability); *Aspen Skiing Co. v. Aspen Highlights Skiing Corp.*, 472 U.S. 585, 610 (1985) (observing that that the defendant "elected to make an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years" and that such conduct "support[ed] an inference that [the defendant] was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival).

[26] *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

[27] *Id.* at 407.

[28] *Id*. The DOJ Section 2 Report likewise embraced this view by basing much of its analysis on theory that the promise of monopoly profits drives firms to innovate and compete. *See, e.g.,* U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM

fairness to Justice Scalia, the Court has more recently acknowledged the benefits of innovation.

The problem with Justice Scalia's assessment, however – apart from the fact that it was completely unnecessary to resolve the issue at hand[29] – is that it goes way too far. While it is true that anticipated financial rewards certainly drive innovation and competition, the observation that monopolies incentivize a monopolist to engage in innovation is meaningless in the Section 2 context so long as it is divorced from the effects that monopolies have on rivals.[30] If the *net* effect of a monopoly is less innovation in the relevant market, whether or not the *monopolist* engages in innovation is beside the point.[31] Indeed, this thinking was the thrust behind many of the government's most prominent recent Section 2 cases, including both *Microsoft* and *Rambus*, where the DOJ and the FTC, respectively, argued that the exclusionary conduct by a monopolist impeded a rival's access to key inputs or to the post-innovation market and thereby reduced the possibility that an industry *in the aggregate* would successfully engage in innovation.

In sum, insofar as *Trinko* suggests that antitrust enforcement against monopolists is somehow anti-innovation, I do not agree with that suggestion. To the contrary, to the

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CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008) [hereinafter REPORT] at 7-8, 49, 119.

[29] In *Trinko*, the one and only question was whether that defendant's *conduct* constituted monopolization, given the regulatory "safety net" that existed.

[30] *See* Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice ("FTC Section 2 Statement") 1 (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf.

[31] *See id.* (noting that the financial rewards resulting from monopoly power do "not guarantee that profits resulting from monopoly power will have the same beneficial market effects as profits resulting from competition").

extent that such enforcement has the net effect of increasing the incentives and ability for competitors to engage in innovation, consumers benefit from such enforcement. The debate about how antitrust should incentivize innovation in the Section 2 context will inevitably continue.

III.

Fortunately (or not depending on your view), Section 2 is not the only weapon in the Federal Trade Commission's arsenal. The Commission can also attack anticompetitive conduct under Section 5 of the Federal Trade Commission Act which, among other things, prohibits "unfair methods of competition." I would not be surprised to learn that most of you have never heard of Section 5. The vast majority of cases challenging anticompetitive conduct are brought under Sections 1 and 2 of the Sherman Act, which prohibit anticompetitive agreements and unilateral conduct, respectively. The Federal Trade Commission, the Department of Justice, and the private plaintiffs bar all have authority to bring claims under Sections 1 and 2 of the Sherman Act in federal district court. When Congress created the FTC in 1914, however, it authorized the FTC to prosecute violations of Section 1 and Section 2, as well as all "unfair methods of competition" under Section 5 through an administrative process, subject to review by the federal appellate courts.

What does it mean to engage in an "unfair method of competition"? This has been a subject of intense debate within the antitrust bar. The most recent guidance we have from the Supreme Court is a 1972 decision in *Sperry & Hutchinson*, where the Court held that Section 5 is not simply coextensive with other federal antitrust statutes, but instead reaches further.[32] Just how far Section 5 should reach beyond the Sherman Act, however, remains an unanswered question and one that the Commission continues to grapple with on a case-by-case basis. To that end, those of us at the Commission have spent a considerable amount of time trying to identify what the appropriate outer limits of our Section 5 enforcement should be. I should emphasize that my thoughts on this topic are mine alone and continue to evolve. With the benefit of having several years now at the Commission to think about Section 5, I would like to identify what I view as five limiting principles on Section 5's reach.

<u>First</u>, the Commission should only use Section 5 in cases where a party's conduct causes anticompetitive effects. To my mind, that includes not only conduct that causes an increase in price or a reduction in output (as the Sherman Act case law requires), but also conduct that causes a reduction in consumer choice, which occurs when a firm's conduct impairs the choices that free competition brings to the marketplace.[33] I see two benefits to looking for such harm in the Section 5 context.

To start, while there has been some recognition over time that the Sherman Act reaches conduct that weakens product quality or innovation, as I have already observed, Sherman Act law is still largely centered on price theory. Nevertheless, consumers also can be harmed when conduct inhibits product development through innovation or limits consumers' options such as by limiting quality or variety. A consumer choice analysis

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[32] *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972). For a through summary of the legislative history underlying Section 5, *see* Neil W. Averitt, *The Meaning of "Unfair Methods of Competition" in Section 5 of the Federal Trade Commission Act*, 21 B.C. L. Rev. 227, 229-38 (1979).

[33] *See, e.g.*, Robert H. Lande, *Revitalizing Section 5 of the FTC Act Using "Consumer Choice" Analysis*, Antitrust Source (February 2009); Robert H. Lande, *FTC v. Intel: Applying the "Consumer Choice" Framework to "Pure" Section 5 Allegations*, CPI Antitrust Journal (February 2010 (2)).

therefore provides a means that is still tethered to a demonstrable standard to analyze anticompetitive conduct in dynamic industries where intense competition typically occurs on things other than just price.

Additionally, a consumer choice standard is faithful to Section 5's text. Section 5 prohibits both conduct that constitutes "unfair methods of competition" (which are thought of as antitrust violations) and conduct that constitutes "unfair or deceptive acts or practices" (which are thought of as consumer protection violations).[34] Far too often antitrust and consumer protection violations are thought of in a vacuum and as divorced from one another. This is likely because we normally think about antitrust violations as sounding only in the Sherman Act or the Clayton Act. But there are cases where a firm's conduct implicates both of Section 5's prongs. The classic case of such conduct is when a firm uses deception to help it establish monopoly power and eliminate competition. In such cases, Section 5 (and arguably not the antitrust laws, which focus more on conduct related to price and output) is the better vehicle for protecting competition and consumers.

<u>Second</u>, the Commission should evaluate whether the Commission will make the law more or less predictable by proceeding under Section 5 (as opposed to the Sherman Act). Another way to think about this is to consider those instances where there are gaps in the Sherman Act that do not provide a vehicle for prosecuting anticompetitive conduct. These gaps arise when the Commission believes that conduct is clearly having anticompetitive effects, but where the Commission determines shoehorning it into a Sherman Act claim would be, at best, a stretch. This could occur where the Commission

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[34] 15 U.S.C. § 45.

believes it cannot prove a statutory element of the Sherman Act (as, for example, in the case of the invitation to collude – or attempted conspiracy – cases where there is an absence of an agreement, which is a necessary element under Section 1). It could also occur, however, where the Commission concludes that, notwithstanding the absence of a common law element, the defendant's conduct is nevertheless causing anticompetitive harm. Section 5 may be appropriate in each of these instances.

To be clear, I do not mean to say that the Commission should simply throw its hands up anytime it faces a hard question of law under Section 2 and retreat to Section 5. We do no one a service if that is our practice.[35] What I do mean to say, however, is that there may be instances where ordinarily courts might find that a rule of Sherman Act law would not impose liability, but where the particular facts of a case nevertheless suggest that liability should attach because a firm's conduct is having anticompetitive effects that are not outweighed by a pro-competitive business justification. In these cases, if we force the case into a Sherman Act framework we run the risk of either making bad law (to bring an unusual case within the ambit of existing precedent) or, alternatively, losing the case even though the firm's conduct is causing anticompetitive effects because of binding

[35] In this regard, I would point out that even though the Commission could have gone the route of analyzing post-*Leegin* resale price maintenance under Section 5, had the Commission done so, it would have lost out on an opportunity to weigh in on the important debate over what standard should apply to analyze resale price maintenance claims under Section 1. The Commission therefore analyzed such conduct under Section 1 in *Nine West*, when we opined that, after *Leegin*, resale price maintenance agreements should be analyzed under a truncated rule of reason and found that Nine West lacked market power and therefore modified our consent decree. *See In the Matter of Nine West Group Inc.*, Docket No. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, *available at* http://www.ftc.gov/os/caselist/9810386/080506order.pdf.

precedent that is ill suited to judge the conduct at hand.[36] In my view, the Commission does a greater service by declaring the practice to be an "unfair method of competition," provided that we clearly articulate – be it in a consent decree or a decision – what that unfair method of competition is and why the conduct constitutes an unfair method of competition so that future parties are on notice. Moreover, the more of these Section 5 cases we actually litigate, the more clarity and finality we can get once and for all on the scope of our Section 5 authority. That certainty ultimately has to be better than the endless debating that the antitrust bar is now engaged in.

Third, the Commission should consider whether the Commission's special expertise adds any value to the case at hand. When Congress enacted Section 5 it gave the FTC – and only the FTC – authority to enforce Section 5. To my mind, this delegation of authority means if the FTC is going to sue a firm under Section 5, it must go after conduct that Congress did not intend for private plaintiffs to be able to pursue under the other federal antitrust laws. Or, put differently, there must be something about the conduct that the FTC, as an expert and independent administrative agency, is optimally positioned (in comparison to the average private plaintiff) to claim is anticompetitive.

When would the FTC add special value? I can envision a few types of cases. One category of cases might be those instances where the conduct is in its incipient stages. The Sherman Act has never been thought of as an incipiency statute and there are

[36] The case law under Section 2 of the Sherman Act may be "binding" (1) when there is a Supreme Court decision squarely on point or (2) when those regional federal appellate courts that have weighed in on an issue agree that Section 2 should be interpreted and applied in a certain way. It should be noted that both instances are the exception rather than the rule.

undoubtedly good reasons for that fact: determining what conduct in its nascent stage is likely to lead to conduct that is more anticompetitive than procompetitive is a challenging task – one that private plaintiffs, generalist judges, and lay juries are arguably ill-suited to attempt. Moreover, the cost of them getting it wrong – creating liability for procompetitive conduct – is far too high. The FTC with its ability to engage in pre-complaint discovery and its in-house experience and expertise in competition and economics is arguably uniquely suited to make those difficult decisions.

As I have already alluded to, another category of cases where the FTC might add special value in comparison to a private plaintiff and/or a generalist district court might be those antitrust claims that hinge on claims of deception. I am thinking here about our standard setting cases (*Rambus* and *N-Data*).[37] In both instances, we alleged that the defendant engaged in fraud on a standard setting organization. As our loss in *Rambus* underscores, antitrust courts are not likely to be receptive to marrying claims of deception with Sherman Act violations.[38] I suspect this is because proving that a party was deceived is not the type of evidence that is normally sufficient to show harm to the competitive process. In some cases, however, such as when there is a gatekeeper (like a standard setting organization), deceiving that entity can cause a breakdown in the

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[37] *Rambus, Inc. v. Federal Trade Comm'n*, 522 F.3d 456 (D.C. Cir. 2008); Analysis of Proposed Consent Order to Aid Public Comment, *In the Matter of Negotiated Data Solutions LLC*, File No. 051 0094 (Jan. 23, 2008), available at http://www.ftc.gov/os/caselist/0510094/080122analysis.pdf.

[38] In *Rambus*, the D.C. Circuit held that, even if Rambus had disclosed its intellectual property to the standard setting organization, the Commission failed to find that the standard setting organization would not have standardized Rambus' technologies anyway. Further, the court reasoned that, even if Rambus had engaged in deception, there was no harm to competition because "an otherwise lawful monopolist's use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition." 522 F.3d at 468.

competitive process because it prohibits the market from making well-informed decisions in the first place. The FTC with its dual expertise in consumer protection and competition law is well equipped to make the hard decisions about the unique circumstances where such deception can trigger an antitrust violation.

Apart from these two examples, there may be other categories of cases where the FTC can lay claim to a special expertise that warrants a finding that the Commission can better challenge certain types of conduct. The Commission is on its strongest Section 5 footing when we can legitimately point to our special experience and expertise as adding significant value.

Fourth, the Commission should consider whether there is any value in avoiding the collateral consequences that may result from proceeding under the Sherman Act. When Congress enacted Section 5, it considered and rejected a provision that would allow private plaintiffs to sue for treble damages. In rejecting such a provision, several members of Congress noted that Section 5's breadth, which allowed the Commission to identify "unfair methods of competition" on a case-by-case basis, made it unfair to penalize firms with treble damages for conduct that they did not know was clearly circumscribed by Section 5.[39] Congress therefore decided that violations of Section 5 should be subject to prospective remedies only. These forward-looking remedies (which may include divestiture and/or licensing) suggest that Section 5 should reach conduct that

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[39] 51 CONG. REC. 11,379-80 (1914) (remarks of Sen. Cummins) (expressing concern that those who violate the act without moral turpitude should not be unfairly punished); *id.* at 13,114 (remarks of Sen. McCumber) (finding treble damages against unsuspecting violator is harsh penalty); *id.* at 13,119 (remarks of Sen. Williams) (expressing concern that businesspeople performing established business practices not be punished retroactively for actions redefined as unfair or unlawful).

the Commission does not trust the private plaintiffs' bar, generalist judges, and lay juries to responsibly evaluate.

Recent Supreme Court precedent, which has shown a disdain for the private class action bar and generalist district court judges in antitrust cases, underscores this view. This frustration has manifested itself in cases that relate to the procedural components of antitrust law – the pleading of an antitrust claim in *Twombly* and the standard for preemption of an antitrust claim in *Credit Suisse*. In both of these cases, the thrust of the Court's concern was the same: the threat of treble damages available for Sherman Act violations combined with the difficulty generalist district court judges and/or lay juries have in drawing lines between procompetitive and anticompetitive behavior created real risks that antitrust defendants would suffer severe financial consequences for conduct that did not harm competition.

This same concern militates in favor of the Commission using Section 5 in cases where there is a pronounced risk that collateral consequences will cause the very outcomes that Congress and, and more recently, the Supreme Court have collectively sought to avoid.

<u>Fifth</u> and most importantly, the Commission should only use Section 5 if it can do so in a way as to minimize the risk of false positives – i.e., that firms will refrain from procompetitive conduct because of a fear that the Commission (or courts) will err in the hard line drawing associated with weeding out procompetitive conduct from anticompetitive conduct. I take this concern very seriously and, in fairness to the defense bar, understand why Section 5 with its broad statutory reach is, on its face, more susceptible to false positives than the Sherman Act with its century plus of common law

history ever could be. Nevertheless, I believe that the Commission can identify substantive limits on its Section 5 authority that should give the defense bar comfort that Section 5 is subject to much more than an "I know it when I see it" test.

To that end, I would impose the following substantive limitations on Section 5 to obviate the false positives concerns. First, apart from those cases which can be viewed as filling the interstices of Section 1 (because, for example, they involve attempted joint conduct), we should limit our use of Section 5 to cases involving ostensibly exclusionary practices by firms with monopoly power where those practices have an anticompetitive effect, which may include preventing a rival from constraining the exercise of monopoly power. Second, Section 5 should generally be used only where a firm has engaged in not just one act, but multiple acts or practices that have an anticompetitive effect.   Third, Section 5 should generally only be used where there is direct or circumstantial evidence of intent or purpose by a firm to achieve an anticompetitive effect.   Requiring proof of all of these elements – a firm with monopoly power that engages in multiple exclusionary acts or practices with the intent and ultimate effect of causing anticompetitive harm by constraining consumer choice – best maximizes the Commission's chances of getting our application of Section 5 right and, in turn, minimizes the likelihood that we deter procompetitive conduct.

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In conclusion, if you take nothing else away today from my remarks, know that we at the Commission are ready and willing to use Section 5 if and when the right case presents itself. Our recent actions should leave little doubt in that regard.

More broadly, however, I want to suggest that Section 5 may supply an optimal vehicle for challenging conduct that weakens innovation. The common law that has grown up around Section 2 over the last several decades is deeply ingrained in price theory; that static framework, however good it may be for evaluating short-run harm and quantifiable conduct such as price and output restraints, does not easily lend itself to looking at whether a party's conduct has or will dampen innovation or prevent product improvement. Compounding matters is the fact that the difficult line drawing and weighing involved in comparing the likelihood of innovation against the likelihood of quantifiable anticompetitive harm is not something that generalist judges and lay juries are well suited for. Indeed, even the metric for measuring innovation itself remains elusive.

If the Commission proceeds under Section 5, these concerns largely fall away. Judging harm to competition against a consumer choice standard not only follows from Section 5's text and the FTC's unique institutional architecture, but provides a ready-made vehicle for evaluating anticompetitive harm from a dynamic perspective. Moreover, by proceeding under Section 5 and suing in our Part 3 administrative process, the FTC (and only the FTC) can have the first crack at the hard line drawing and balancing that must occur when one weighs price competition against other forms of more dynamic competition. Arguably by leaving this critical task to the FTC and its prosecutorial discretion in the first instance, Section 5 allows the Commission to minimize the threat of false positives and shake down lawsuits that have animated many of the Supreme Court's more recent decisions. For all of these reasons, I would not be surprised if the Commission decided to pursue claims based on dynamic concerns under

Section 5 in the coming years, provided we can provide clear guidance to parties about when their conduct will trigger Section 5 review.