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The Sword of Damocles:
The Slender Thread of Expanded Antitrust Conduct Claims

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"If the threat of [an antitrust action] is going to help us more with their programming than doing it, then keep the threat."

~President Richard Nixon[1]

"[K]eeping this case in a pending status gives us one hell of a club on an economic issue that means a great deal to those three networks ... something of a sword of Damocles."

~Charles W. Colson, advisor to President Nixon[2]

Many thanks to Sean Heather and the Chamber of Commerce for hosting me today. I greatly appreciate the opportunity to share my thoughts with you on proposals to alter the standards by which we assess business conduct under the antitrust laws.

We gain useful perspective when we place current events within the arc of history. Today, I would like to roll back the clock several centuries. Shortly after his father died in 367 BCE, Dionysius the Younger inherited control over the ancient city of Syracuse. When Damocles, a member of his royal court, commented on the ruler's wealth and good fortune, Dionysius offered to switch places with him. Damocles accepted and assumed his place on a bed of gold. Before he could get too comfortable, Dionysius hung a sword from the ceiling by a single horse hair right above Damocles' head. The stress of the impending fall of the sword became so great that Damocles begged Dionysius to allow him to leave. Dionysius, having proven his point, allowed Damocles to go back to his normal life.[3]

You might be wondering how Damocles' sword is relevant to antitrust. In 1971, then-President Richard Nixon and his senior advisor Chuck Colson may have been the first to make the connection. According to transcripts of White House tapes, President Nixon understood that the threat of an antitrust action against the three major television networks was a powerful tool.

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He recommended preserving the threat rather than bringing an antitrust action, and Colson agreed, calling that threat "something of a sword of Damocles."[4] I believe this popular anecdote, often used as a reminder that there is always danger for those in a position of power,[5] provides a unique perspective on recent proposals to expand antitrust conduct enforcement. But before we jump forward a few millennia to today's discussion, I must give the standard disclaimer that the views I will share today are my own and do not necessarily reflect the views of the Federal Trade Commission or of any other Commissioner.

Antitrust law enforces against "the willful acquisition or maintenance of" monopoly power.[6] This unlawful conduct is "distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[7] This distinction "induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct."[8] To that extent, the sword should not hang over the head of business when the "opportunity to charge monopoly prices—at least for a short period—is what attracts business acumen in the first place."[9]

Consider Damocles and recent proposals to expand certain conduct claims under Section 2 of the Sherman Act. Is it possible that punishing success under the antitrust laws will cause businesses to fear attracting too many consumers with popular products and services? Or is it possible that increased uncertainty under the antitrust laws will cause businesses to reduce investment due to fear of too much success? The answer depends on the future of antitrust law. If enforcers treat success gained through business acumen the same as dominance gained through anticompetitive conduct, then the answer is yes—the incentive to be successful is diminished. The House Judiciary Committee's Majority Staff Report[10]—published last fall after the committee's investigation of the GAFA companies—argues for proposals that threaten to treat success as an antitrust violation. The sword should be in the firm grip of enforcers, ready to fall on those who create or maintain a monopoly through anticompetitive conduct, not precariously placed to threaten those who succeed by delighting consumers.

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[4] *See supra* notes 1-2.

[5] *See generally* Connor Mortell, *The Sword of Damocles Hangs over Every Property Owner*, MISES W

While the Majority Staff Report contains many proposals governing conduct, I will focus on three: (1) expanding the essential facilities doctrine; (2) removing the current predatory pricing recoupment standard; and (3) finding antitrust violations in product design changes that benefit consumers.

First, I will take a close look at the essential facilities doctrine, including the Supreme Court's role—or lack thereof—in its creation. I then question the impact this doctrine has on incentives to invest and innovate.

I will then discuss proposed changes to our predatory pricing framework that will discourage businesses from offering low prices and question the outcome that proponents of this proposal hope to achieve.

And finally, I will provide a warning about proposals to disregard consumer benefits when analyzing design changes. Here, I question the intended beneficiaries of these proposals.

1. **Essential Facilities Doctrine**

I will start with proposals to breathe new life into the essential facilities doctrine. The Majority Staff Report recommends revitalizing the essential facilities doctrine.[11] Proponents are concerned that "denial of access in one market can undermine competition across adjacent markets, undermining the ability of market participants to compete on the merits."[12] This perspective is flawed because it is static; the essential facilities doctrine does not view the economy as dynamic or industries as innovative. The doctrine identifies a "facility" controlled by one competitor and concludes access would be helpful for other competitors.

It is for this reason that commentators have described the essential facilities doctrine as a "taking."[13] The Takings Clause of the Fifth Amendment to the U.S. Constitution provides that

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[11] MAJORITY STAFF REPORT, *supra* note 10, at 397-398 ("[T]he Subcommittee recommends that Congress consider revitalizing the 'essential facilities' doctrine, the legal requirement that dominant firms provide access to their infrastructural services or facilities on a nondiscriminatory basis. To clarify the law, Congress should consider

private property shall not be taken for public use without just compensation.[14] It is established that regulation can be classified as a taking.[15] But the extent to which these "takings" are allowed depends, at least partially, on the identification of "important public interests."[16] Unsurprisingly, these takings can lead to backlash, as displayed in *Kelo v. City of New London*[17] and the resulting political response to the unpopular decision.[18] Thus, the Takings Clause provides one final reason to tread lightly in this area. Once antitrust law determines that a facility is "essential," the government is allowing rivals to seize access. To avoid antitrust violations, a firm with a popular good or service will have no choice but to share the benefit of its success with its competitors.

a. <u>Incentive to Invest</u>

But what effect does this mandated access have on the incentive to construct facilities that risk being designated essential? Some critics argue that small firms need access to certain facilities so that they can develop their own infrastructure. An economic examination of countries that mandated access to unique facilities showed reductions in investment.[19] A study of these policies found that they do not create a so-called "ladder of investment" that leads small firms to build their own facilities.[20]

By adopting a static perspective and failing to consider future investment, antitrust policy can actually harm innovation. The incentive to risk investment in research and development is weakened with the threat that rivals successfully could demand access to costly developments. In this context, competitors would no longer need to out-compete their rivals because they could take some of what their competitors built. "Faced with this potential onslaught, a company understandably might question the value of investing in new assets and technologies."[21] With the sword of Damocles–here, the threat of compulsory sharing–hanging over its head, a company may conclude that average assets and technologies look like a better option than vigorous competition.

Some courts find that a legitimate business justification is a defense to an essential facilities claim.[22] But as the late Professor Phillip Areeda explained, businesses refuse to share with competitors because they want to win customers[23] and required sharing disincentivizes investments that would benefit consumers.[24] In other words, the refusal itself is a business justification because the defendant never would have built the facility in the first place if he had known he would be required to share it.[25]

b. History and Supreme Court "Precedent"

To understand the modern essential facilities doctrine, it is helpful to examine its history. The problems of access to a unique facility—and the specific legal principles to address these issues—date back to the Middle Ages. Both common law and statutes to address access issues developed based on many factors, including what facility is deemed essential, the access recipient, the nature of the relationship between the recipient and provider, and the circumstances impeding accessibility.[26] Obligations to provide access to products or services deemed essential can be traced back to the rules imposed on common carriers from the English common law of public callings dating back to 1349.[27] Similar obligations were imposed on public utilities when they emerged in the nineteenth century.[28] These private corporations were granted—by the

[21] Christine S. Wilson, Opinion, *A Court's Dangerous Antitrust Overreach*, WALL ST. J. (May 28, 2019), https://www.wsj.com/articles/a-courts-dangerous-antitrust-overreach-11559085055 (suggesting this concern in the context of an expansion of *Aspen Skiing*).

[22] *See, e.g.*, City of Anaheim v. S. California Edison Co., 955 F.2d 1373, 1380 (9th Cir. 1992) ("It should also be pointed out that the fourth [essential facilities] element basically raises the familiar question of whether there is a legitimate business justification for the refusal to provide the facility, as application of the doctrine in *MCI* itself demonstrates.").

[23] Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841, 849-50 (1990) ("Of course, the reason any business declines to share the fruits of its labor with competitors is because it wants to win in the marketplace.").

[24] *Id.* at 851 ("Required sharing discourages building facilities such as this, even though they benefit consumers.").

[25] *Id.* ("For example, the justification for refusing to share a research laboratory does not focus on the practical infeasibility of letting another use the laboratory, but on the general concern that the defendant never would have built a laboratory of that size and character in the first place if he had known that he would be required to share it.").

[26] Barbara A. Cherry, *Utilizing 'Essentiality of Access' Analysis to Mitigate Risky, Costly and Untimely Government Interventions in Converging Telecommunications Technologies and Markets*, 11 COMMLAW CONSPECTUS 251, 252 (2003), https://scholarship.law.edu/cgi/viewcontent.cgi?article=1268&context=commlaw.

[27] *Id.* at 255-57 (discussing the history of legal principles put in place to address the problem of access to essential services or facilities).

[28] *Id.* at 257.

government—the privilege to provide a service of public importance.[29] This privilege came with an affirmative duty for the utility to provide its service to any member of the public.[30]

In the U.S, the essential facilities doctrine has never been expressly applied by the Supreme Court.[31] Proponents of the doctrine, however, cite four Supreme Court cases as providing precedent for its creation well before circuit courts put the doctrine into practice.[32] The first cases involve concerted action, not unilateral conduct. Of course, allegations of coordination among competitors receive the closest antitrust scrutiny.[33] It is questionable whether cases rightfully scrutinizing concerted action can act as informative precedent when considering unilateral conduct cases. These cases, along with two unilateral conduct cases, were twisted and convoluted until an essential facilities doctrine was created by lower courts. I hope that by examining how the Supreme Court led us to where we are, this knowledge can lead us to a sensible solution for the future of the essential facilities doctrine.

The earliest case cited as supporting the essential facilities doctrine is *United States v. Terminal Railroad Association* from 1912.[34] This case involved notorious financier Jay Gould,[35] who organized a coalition of 14 railroads lines to acquire every railroad facility at an important junction where 24 railroads lines terminated.[36] The Supreme Court found that the combination of every facility under control of only some of the competitors violated Sections 1 and 2 of the Sherman Act as a combination in restraint of trade and attempted monopolization.[37]

The DOJ suggested dissolution of the coalition,[38] a seemingly appropriate remedy for concerted action among competitors. B whether it was a competitor.[45] The majority acknowledged that it would be impossible to know whether members considered competition when deciding on a new member's application, but trusted the AP to "faithfully" follow the decision.[46]

The first unilateral conduct case often considered fundamental to the development of the essential facilities doctrine was decided by the Supreme Court three years later in 1948. In *United States v. Griffith*, a movie theater owner with a monopoly in some towns was accused of using his bargaining power to force producers to impose unfavorable terms on competing theaters in towns where the defendant had competitors.[47] No claim was made that the defendant had anything "essential" or even needed to supply anything to a competitor. But commentators view the case as relevant to the essential facilities doctrine because of broad dicta that stated, "the use of monopoly power, however lawfully acquired, to foreclose competition, *to gain a competitive advantage,* wholesaler to an independent utility).[51] The Supreme Court upheld a Section 2 violation against the defendant for refusing to supply power at wholesale to municipality power systems that competed with it for retail customers and for refusing to wheel power from other wholesale providers to those municipalities.[52] The defendant argued that because it was regulated the antitrust laws should not apply.[53] Regulation did act to encourage interconnections,[54] but the law did not fully regulate the wholesale provision of electricity and did not regulate at all the them must allow them to be shared on fair terms."[58] The District Court viewed that statement as "epitomiz[ing the time this case was decided in 1985—had been fleshed out by other lower courts.[66] The Supreme Court affirmed that the with competitors.[75] Competing LECs complained that to protect competition.[83] The nature of the regulatory framework in *Trinko* diminished antitrust harm because the regulations and commitments were enforced and continuously overseen by the Federal Communications Commission.[84] Failure to comply was met with corrective punishment, suggesting the regulator here was an effective steward of the antitrust function."[85] In fact, the Court found that the communications law and regulations at issue were "much more ambitious than the antitrust laws."[86]

We now benefit from wise analyses and correct conclusions in practice, policy, and law. In practice, economic analysis shows us that mandated access can reduce investment and does not necessarily lead small firms to build their own facilities.[87] In policy, Professor Areeda's analysis explained that businesses refuse to share the fruits of their investments precisely for the purpose of winning customers and that forced access will disincentivize these investments that benefit consumers.[88] And finally, the Supreme Court in *Trinko* reached similar legal conclusions. It correctly limited the reach of *Aspen Skiing* as "at or near the outer boundary of [Section] 2 liability."[89] The Supreme Court highlighted that a firm is allowed toisy,yhayhadala al]ft6(on].-t)6 (lt8t)6 (lt8t)6 (

anticompetitive conduct.[91] Judicially enforced sharing would instead put courts in the role of central planners, abandoning markets as the best method of reaching the proper price and quantity of goods and services.[92]

2. Predatory Pricing

Similar concerns apply to calls to reform the predatory pricing standard. The Majority Staff Report recommends overriding Supreme Court precedent to clarify that it is not necessary to prove that losses were or could be recouped.[93] I question the report's recommendation because it mischaracterizes the standard and discourages low prices and innovation.

First, the standard is misunderstood. Current Supreme Court precedent does not require proof that actual recoupment be possible. Instead, it requires a "close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market" to determine whether a "reasonable prospect" or "dangerous probability" of recoupment exists.[94] Showing that something could happen and showing that something has a prospect or probability of happening is not the same thing. The standard is lower than the report implies.

Second, this standard was adopted so as to encourage low prices and innovation. The report provides a prime example in citing Amazon as having "adopted a predatory-pricing strategy across multiple business lines at various stages in the company's history," including at the earliest stages before Amazon turned a profit.[95] This strategy is exactly how an entrant convinces people to take a chance on a new company or business model. Amazon offered low prices and low-cost or free delivery to encourage consumers to try its platform. Critics would prefer to hang the sword of Damocles–here, the threat of antitrust enforcement for prices that are "too low"–over any company that considers attracting consumers with low prices.

This concern about low prices is not new. In the 1930s, Congress passed the Robinson–Patman Act to target the buying power of large chain stores that drove down prices, thereby making it more difficult for smaller operations lacking scale to offer competing prices to

[91] *Id.*

that more parts of the American economy should "operat[e], on a more reasonable, human scale" and these companies "show us the way to a better, fairer economy."[101]

If you are confused by what "better," "fairer," and "reasonable human scale" means in the antitrust context, you are in good company. As Professor Herbert Hovenkamp highlighted in a recent article, the neo-Brandesians have a "problem of transparency" and if they communicate their goals in advance, it "could spell political suicide." [102] Professor Hovenkamp notes that their attack on low prices will harm consumers, especially the most vulnerable who rely on low prices to feed their families and meet other essential needs.[103]

3. **Product Design**

Another

As Professor Areeda described, gaining market share through innovating, cutting costs, and discovering customer preferences is the exact behavior that antitrust policy, in its current formulation, encourages.[109] Banning product improvements that harm a competitor—even if those improvements are good for consumers—will dampen the incentives of rivals to innovate in response to competitive pressures. For example, if a competitor offers a service as a third party and a rival integrates this service into its own product, the competitor might be harmed through lower sales. If consumers prefer the ease of integration and the lower—or even free—price offered through integration, the competitor is likely to be harmed through lower sales. This design change, which improves quality and lowers price, would be illegal under these new proposals.

Consider the three-point seat belt invented by Volvo in 1959 that estimates suggest has saved hundreds of thousands of lives.[110] Every major car company copied this invention after Vol

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beneficial product changes. My concern flows from the fact that these proposals will hang the sword of Damocles over every business that contemplates developing uniquely desirable assets, offering low prices, and improving its products and services for consumers. I submit that few proponents of antitrust reform would enjoy being viewed as emulating President Nixon. Let’s leave the sword of Damocles hanging in the fourth century %&., where it belongs.

Thank you again to Sean Heather and the Chamber of Commerce for giving me an opportunity to share these concerns with you today.