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# Antitrust and Propety (Including Intellectual): First Principles

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# Antitrust and Property (Including Intellectual): First Principles

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Judge Easterbrook opened the proceedings with insightful remarks on antitrust and information generally. Much of what Judge Easterbrook had to say in his keynote address relates to the problem that antitrust takes too static a view of markets when a particular case arises. The growing focus of antitrust on prices and quantities (as opposed to preserving a "small is beautiful" economy,[1] one that protects "small dealers and worthy men"[2]) is certainly laudable. But when litigation arises, whether prices are higher and quantities lower nonetheless tend to be judged as things of the moment. That analysis is overly static.

So, as Judge Easterbrook said, too often the possibility that new entry may well solve any anticompetitive problems is ignored. True, there are opinions like that of Judge Winter in the *Waste Management* case, carefully considering the possibility of entry and relying heavily on it.[3] But more typically, entry is ignored, or its importance minimized. The Department of Justice/Federal Trade Commission Merger Guidelines,[4] for example, only pay attention to entry that will occur within two years.[5]

Why only two years? In a good, rip-roaring antitrust case, *discovery* lasts more than two years. After thirteen years of litigation in the IBM case, no decision was in sight. If the courts can't resolve problems of competition within two years, why should

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1 See generally, Ernst Friedrich Schumacher, *Small is Beautiful: Economics as if People Mattered* (Harper 1993).

2 *United States v Trans-Missouri Freight Association*, 166 US 290, 323 (1897).

3 *United States v Waste Management, Inc*, 743 F2d 976, 982 (2d Cir 1984) ("The Supreme Court . . . has held that appraisal of the impact of a proposed merger upon competition must take into account potential competition from firms not presently active in the relevant product and geographic markets.").

4 U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* (GPO 1997).

5 Id at § 3.2.

markets be held to that standard as a condition of avoiding government interference?

Even were there no supply-side reactions to anticompetitive thrusts, other dynamic forces are usually at work on the demand side. Consumer desires change, often in response to technological developments in other markets that make new products available. A monopoly in, say, cassette stereo players, while quite possibly lucrative some time ago, is of little importance now that CDs are the norm, and even they may fast become a thing of the past with MP3 players' increasing popularity. An alleged monopolist of baseball cards has little anticompetitive potential once boys' tastes switch to Pokemon cards.

Judge Easterbrook made an important point with respect to the overly static nature of antitrust when he observed that, if plaintiffs are successful, much antitrust would effectively freeze progress in otherwise rapidly evolving markets. His point is particularly salient when it comes to information markets, and Judge Easterbrook mentioned a few computer-related cases.[6] But he could just as well have been describing more mundane products, such as Instamatic cameras. In the *Berkey Photo* case, it was defendant Kodak's speed and extent of innovation about which plaintiffs complained.[7] Although the plaintiffs in *Berkey Photo* were unsuccessful, there is every chance that the public and private plaintiffs in the various Microsoft cases will not come away so empty-handed, even as consumers reveal their preferences for newer products and markets in which Microsoft competes fiercely.

In the spirit of Judge Easterbrook's remarks, let me begin by noting a similar problem of antitrust's overly static nature that relates to intellectual property issues. The problem derives from the way that antitrust law often has viewed property more generally. Modern antitrust law commendably focuses on consumer welfare, particularly as measured by prices consumers pay. Under the standard welfare-economic paradigm, lower prices translate directly into increased consumer welfare. And so it follows that producer activities (concerted or unilateral) that raise price—such as directly fixing prices or practices that reduce quantities and so raise price indirectly—are undesirable.

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[6] Frank H. Easterbrook, *Information and Antitrust*, 2000 U Chi Legal F 1, 8–9.

[7] *Berkey Photo, Inc v Eastman Kodak Co*, 603 F2d 263, 279, 283 (2d Cir 1979) (describing Berkey Photo's allegations).

That in itself seems unobjectionable, even praiseworthy, especially when measured against older antitrust notions of protecting competitors.[8] But in some situations, focusing on prices and quantities can be a mistake, if consumer welfare is the objective of antitrust. To talk of the price charged or the quantity produced for any good is implicitly to assume that the good exists. But what if higher prices (and/or restricted quantities) are necessary for the good to come into existence in the first place?

The law concerning patents explicitly recognizes that this can happen. Monopoly rents are permitted—indeed, encouraged—as an incentive to bring the good into existence. Higher prices are the reward for the up-front investment necessary to create the patented product. Antitrust has not been indifferent to how the rents are earned (that is, how the patents are used). But the basic idea is not questioned that some goods will not be created this year unless a subsequent period (say, seventeen years) of monopoly rents is allowed. As Judge Easterbrook wrote in an influential article fifteen years ago, "the grant of patent rights, though creating a restriction of output during the patent's life, is important to give people incentives to invent. There is a tradeoff between optimal incentives ex ante and optimal use of existing knowledge."[9]

The point that people must have an incentive to incur the up-front costs of invention is not controversial in the slightest for patents. Further, the Supreme Court has been deferential of collective activity raising prices in other intellectual property areas, such as copyright, because that activity also generates new property.[10] In that respect as well, it is acknowledged that there is an up-front investment which, like work on products that can be patented, will subsequently require higher prices than would otherwise obtain.

Antitrust, however, typically draws the line between rights officially granted by statute (the patent or copyright laws, for example) and attempts to create intellectual property *not* protected by statute. Suppose, for example, that the product at issue is original dress designs that are being stolen by "style pirates" who then sell the "knock off" designs at lower prices, as of course they can do since they have not expended any resources in the de-

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8 See, for example, *Brown Shoe Co, Inc v United States*, 370 US 294 (1962).

9 Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex L Rev 1, 13 (1984).

10 *Broadcast Music, Inc v Columbia Broadcasting System, Inc*, 441 US 1, 18–22 (1979) (describing invention and necessity of the blanket license).

signing. The style pirates are nothing more than free-riders on the creative efforts of the original-design manufacturers.

Avoiding free riding on others' creative efforts is precisely the problem that patent and copyright protection is supposed to solve. In the long run, if the free-riding is not stopped, the amount of creative activity will diminish (if not disappear altogether). If antitrust were a consistent body of law, it would treat creation of new designs the same way it treats patents. Just as patents protect the creative efforts of patentors and antitrust law allows patent holders to charge higher prices for their patented products, antitrust would also defer to private self-help efforts to accomplish the same thing achieved by patents.

However, antitrust law takes the opposite view, focusing only on the higher prices charged later but ignoring the role of those higher prices in causing the product to come into existence in the first place. The style piracy case described above is familiar to all antitrust lawyers, resulting in a judgment of per se illegality against the dress designers collectively trying to prevent theft of their original designs by boycotting retailers purchasing from the style pirates.[11] Other cases could be cited in which attempts at creation of property likewise were penalized by antitrust laws.[12]

The point is that *all* new products fit the economic model of patent and copyright law. All require fixed-cost investments up front, and thus also require some ability to charge prices that risk seeming supracompetitive (that is, above the cost of making the product), resulting in a reduction of quantity as compared to the quantity that would be sold if prices were lower. The marginal cost for use of informational technologies is usually very low, once those technologies have been developed. On the other hand, the up-front fixed costs of developing those technologies are relatively high.

There are contractual ways that informational inventors and innovators can try to assure themselves of recouping the costs of these investments. But they risk running afoul of the law, especially if they allow the innovator to become a dominant firm in the market and so subject to increasing scrutiny under § 2 of the

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[11] *Fashion Originators' Guild of America, Inc v FTC*, 312 US 668 (1941).

[12] See, for example, *United States v Topco Associates, Inc*, 405 US 596, 608 (1972) (collective creation of a new brand name requiring territorial exclusivity declared per se illegal).

Sherman Act. The *United Shoe* case is an excellent example of this problem.[13]

Finally, it should be noted that entrepreneurs invest in things other than patents, copyrights and other intellectual property. They invest in capital of all sorts, such as human capital and reputational capital. While the form of capital created is different from that commonly characterized as "intellectual property," the economics of the creation are no different. Up-front investments are made in the expectation that, if successful, the investments will yield higher returns in the future. And thus the possibility of antitrust challenge down the road must be anticipated.

But because this line of discussion takes us away from the subject of immediate interest, I will stop here. Suffice it to say that the worlds of antitrust and intellectual property are not always in sync, and that attempts to get them in better alignment are both interesting and important.

[13] *United States v United Shoe Machinery Corp*, 110 F Supp 295, 297 (D Mass 1953) (describing defendant's business practices and rise to monopoly power in the industry).