



HOW GLOBAL ANTITRUST LAWS STRING UP, BEAT DOWN,
AND HOLD BACK AMERICA'S LEADING INNOVATORS

DANIEL R. BALLON, PH.D.

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EXECUTIVE SUMMARY

- “Antitrust” describes a 120-year-old concept that governments should act to protect and promote a competitive marketplace.
- These laws give the government unlimited authority to punish and manipulate dominant firms based on the complaints of competitors. As a result, the system encourages struggling companies to lobby for government-imposed retribution against their more popular rivals.
- In the past decade, contenders in an increasingly competitive technology sector have embraced the power of antitrust to handicap successful players and manipulate rapidly changing markets.
- The willingness of governments to challenge successful tech firms has increasingly led these companies to siphon resources away from research and innovation in order to fund aggressive lobbying campaigns. Since 2000, total lobbying expenditures in the technology sector have doubled. Today, computer and Internet firms spend more on lobbyists than any other industry except pharmaceuticals, insurance, and electric utilities.
- While the 10 largest high-tech companies have bolstered their arsenal of antitrust lobbyists by 60 percent since 2000, these companies’ closest competitors have expanded antitrust lobbying operations 15-fold. Smaller rivals aggressively abuse antitrust as a powerful weapon to game the system and gain unfair advantages over popular competitors.
- These laws provide little benefit to consumers in the digital age, where monopolies are only fleeting illusions. Low overhead costs and rapid innovation ensure that no market leader can hide from agile competitors or revolutionary new technologies. When regulators succumb to the “cybertrust illusion,” they subject thriving markets to special interests and corrupt political interference.

- The opportunities for antitrust abuse are rapidly expanding as foreign governments craft their own policies to extort large fines from America's technology leaders. To date, 113 countries have adopted competition laws, and many regimes view antitrust as a political tool for asserting control over global commerce and protecting state-subsidized entities from foreign competition.
- The case studies of Microsoft, Intel, Apple, and Qualcomm demonstrate how governments and competitors conspire to punish leading innovators for their success and foist inferior products on consumers.
- If policy makers do not act to stem the rise of global antitrust abuse, it threatens to dismantle the high-tech pioneers of today and drive away the most innovative entrepreneurs of tomorrow.

CRAFTING COMPETITION: Let the Games Begin

Culturally, Americans have always welcomed competition. Consumers enjoy more choices and lower prices when companies compete for their business. While few doubt the benefits of competition, two key questions remain: What is the optimal amount of competition in a given market? If the level is deemed insufficient, can the government create more?

For more than a century, these questions have been addressed by a collection of laws known as “anti-trust.” These laws often empower bureaucrats to manipulate markets arbitrarily under the banner of “competition.” As a result, antitrust has become a double-edged weapon, designed to foster competition but capable of being wielded for revenge. Unfortunately, as this study will demonstrate, antitrust laws are applied inconsistently and are vulnerable to corruption. They actually work to reinforce monopolies and restrict competition—the opposite of the intended effect.

Over the past decade, this government-led market manipulation has spread into the innovative and rapidly changing technology sector. In a borderless global online community, every country possesses equal authority to craft its own antitrust laws, and as such can now play a role in dictating the rules for e-commerce.

As governments around the world adopt the idea of “protecting competition,” new technologies will be under threat of extortion by a vast patchwork of protectionist policies. This paper examines the precedent set by U.S. regulators in using antitrust to shape technology, and the disastrous consequences of enticing foreign governments to follow suit.

The Circle of Trust: A Brief History of Competition Law

Although many countries have adopted antitrust laws, it was America that first introduced the concept. Ironically, America had declared its independence from Great Britain to protest exactly this type of harmful government interference. For America's innovators, the competition game has come full circle.

The United States was founded on the principle that success should derive from merit, not government favoritism. More than 15 years before passage of the first antitrust laws, former Supreme Court Justice John Archibald Campbell warned against state meddling in private commerce. Recounting the British monarchy's oppression of American colonists, Campbell argued in 1873 that the "long and wasting struggle for independence" was fundamentally a fight for "freedom. Free action, free enterprise—free competition."¹

The founding fathers rejected any government interference in commerce, viewing such practices as tools for granting special privileges and excluding competition. As explained by economist Peter Dooley, the British embraced "a system of government policy based on commercial favoritism, grants of monopoly privilege, restraints on trade, government subsidies, discriminatory taxes and similar forms of state intervention in the marketplace."² According to historian Norman Risjord, Thomas Jefferson regarded this system as "an 'unnatural' policy that provided government awards to 'parasites.'"³

These awards spawned enduring monopolies, created and protected by the government. When the monarchy attempted to help one such monopolist, the British East India Company, eliminate competition in the colonial tea trade, colonists revolted. Days before the Boston Tea Party in 1773, a widely circulated pamphlet warned that this company, with a "designing, depraved, and despotic Ministry to assist and support them," could soon "monopolize the whole trade" and then "sell goods at any exorbitant price."⁴

Only 117 years after this act of defiance, the first antitrust law reestablished the oppressive and protectionist government powers that America had revolted to defeat. This law was proposed in 1888 by Senator John Sherman of Ohio, the younger brother of Civil War general William Tecumseh Sherman, supposedly to challenge the unchecked growth of corporations. In the late 19th century, a number of dominant manufacturers consolidated within their industries to optimize efficiency and meet the demands of the industrial age. These large corporations became known collectively as "trusts," defined by historian Noel Kent as "a generic term for those firms with enough market muscle to dominate entire industries."⁵

The Sherman Antitrust Act is frequently portrayed as a pro-consumer measure designed to prevent monopolists from squeezing competitors out of the market, depressing production, or charging inflated

prices. Supreme Court Justice Thurgood Marshall even proclaimed in 1972 that “antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”⁶

THE ORIGINS AND IMPLEMENTATION OF
ANTITRUST ARE DEEPLY ROOTED IN
POLITICAL MANEUVERING AND THE
INFLUENCE OF SPECIAL INTERESTS.

Despite these grandiose assertions, the Sherman Act was never intended to benefit consumers. Rather, the origins and implementation of antitrust are deeply rooted in political maneuvering and the influence of special interests. At the time of its passage, no public harm of any urgency could justify Sherman’s bill. In fact, the increased efficiency resulting from consolidation enabled trusts to offer consumers more products at lower prices.

As economist Thomas DiLorenzo explains, “there is no evidence that trusts in the 1880s were restricting output or artificially increasing prices.” In fact, “falling prices accompanied the rapid expansion of output in the ‘monopolized’ industries.” This leads DiLorenzo to conclude that “perhaps it would be more accurate to describe the Sherman Act as an anti-price-cutting law.”⁷ Northwestern University law professor Fred McChesney likewise finds that “the trusts were doing exactly the opposite of what economic theory says a monopoly or cartel must do to reap monopoly profits.”⁸

Sherman himself, talking of cases where consumers suffered at the hands of the trusts, acknowledged that “I know of none such.” Less than six months later, however, he railed against “the evils which unquestionably grow out of these combinations and Trusts.”⁹ What triggered this sudden change of heart?

The motivations that spawned Sherman’s antitrust bill are identical to the motivations that continue to drive the implementation of antitrust today: revenge and political opportunism. A recent review of media accounts surrounding the bill’s passage explains: “Sherman believed that he lost the 1888 Republican presidential nomination because of the Machiavellian scheming of the trusts and their suspicions that he might not prove reliable.” Though he previously supported the trusts and actively courted their support, Sherman “had personally discovered the evil of the trusts only . . . immediately after he had failed to obtain the votes of a majority of the delegates to the Chicago convention.”¹⁰ London School of Economics scholar William Letwin notes that Sherman openly directed his anger during floor debate against the trust headed by “General Russell Alger, one of his chief rivals in 1888 for the Republican presidential nomination, whom Sherman blamed for his unexpected defeat and publicly accused of having bribed delegates.”¹¹

Though partially motivated by revenge, Sherman also hoped the act would serve as political cover for his party’s efforts to shield selected trusts from foreign competition by means of tariffs. Tariffs restrict

competition by raising the barrier for new competitors to enter the market. DiLorenzo notes that “a major political function of the Sherman Act was to serve as a smoke screen behind which politicians could grant tariff protection to their big business constituents while assuring the public that something was being done about the monopoly problem.”¹²

Only three months after passage of the antitrust act, Sherman sponsored a new bill that raised tariffs and further protected monopolies from competition. That sponsorship counters the perception that Sherman was a crusader against “big business” interests. An editorial in the *New York Times* dubbed Sherman’s legislation “the campaign contributors’ tariff bill” and declared that the “so-called Anti-Trust law was passed to deceive the people and to clear the way for the enactment of this Pro-Trust law relating to the tariff. It was a humbug and a sham.”¹³

Indeed, this “sham” produced the desired effect. Not only was the antitrust law completely ineffective in curbing the growth of trusts, but Sherman’s new tariffs ushered in a “golden era” of corporate consolidation. According to Wesleyan University professor Marc Allen Eisner, “between 1897 and 1904 the nation experienced a giant wave of mergers in which 4,227 firms merged to create 257 combinations . . . During this period of industrial consolidation, one percent of the nation’s companies came to control the production of some 45 percent of manufactured goods.”¹⁴

While often portrayed as a landmark example of regulation serving the public interest, the Sherman Antitrust Act actually exemplifies the worst consequences of government interference in free commerce. The law’s vague and sweeping language invites subjective interpretations, allowing lobbyists and special interests to bypass the market and hobble competitors. Ironically, the very characteristics that make the statute so destructive were initially welcomed by influential businessmen who believed it would be impossible to enforce such a broad mandate.

SHERMAN ANTITRUST ACT ACTUALLY
EXEMPLIFIES THE WORST CONSEQUENCES
OF GOVERNMENT INTERFERENCE IN
FREE COMMERCE.

In sweeping language, the Sherman Act proclaims that “every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be illegal,” and that any person monopolizing “any part of the trade or commerce . . . shall be deemed guilty of a felony.”¹⁵ The unenforceability of this law as written was summarized by the Supreme Court in 1978: the Sherman Act “cannot mean what it says,” because “restraint is the very essence of every contract; read literally, [it] would outlaw the entire body of private contract law. Yet it is that body of law that . . . enables competitive markets—indeed, a competitive economy—to function effectively.”¹⁶

William Shughart and colleagues point out that the business sector displayed a “puzzling lack of opposition to the Sherman Act, a law which on the surface was antithetical to its interests.”¹⁷ The bill inspired

little debate or opposition because it was viewed as a hollow and unenforceable distraction from Congress's true intention to shelter large corporate donors with higher tariffs. After a thorough examination of the *Congressional Record*, Peter Dickson and Philippa Wells reach "the inescapable conclusion" that "the senators wished the act to remain obscure and ambiguous in its meaning and enforceability—a piece of legislation that a corporate lawyer could drive a truck through."¹⁸ Even Senator Sherman himself offered reassurance to the business community that the bill would be "totally ineffective" because "all corporations can ride through it or over it without fear of punishment or detection."¹⁹

Though Sherman's prediction was initially realized, his plan backfired in the early 20th century as zealous politicians and judges exploited the act's vague language to impose vast new regulatory authority over interstate commerce. Theodore Roosevelt assumed the mantle of "trust buster," declaring in his second State of the Union message that "we are not attacking the corporations, but endeavoring to do away with any evil in them. We are not hostile to them; we are merely determined that they shall be so handled as to subserve the public good."²⁰ According to Arthur Johnson, Roosevelt sought the "power to draw the line for the public between 'good' and 'bad' [mergers],"²¹ allowing him to subject private enterprise to arbitrary political review.

SPECIAL INTERESTS ADOPTED ANTITRUST AS AN EFFICIENT MECHANISM FOR LOBBYING THE GOVERNMENT TO OBTAIN SPECIAL FAVORS AND WEAKEN SUCCESSFUL COMPETITORS.

In this manner, special interests adopted antitrust as an efficient mechanism for lobbying the government to obtain special favors and weaken successful competitors. The rise to dominance of John D. Rockefeller's Standard Oil and its prosecution by Roosevelt established a pattern that continues to characterize most antitrust cases today. First, a business wins over customers with superior technologies, new practices, or lower prices. Next, rivals argue that the dominant company's popularity gives it dangerous power to exclude competitors and raise prices. Finally, "public interest" groups embrace these claims and mobilize political support for disbanding or punishing the company for its success.

In Rockefeller's case, economist Dominick Armentano explains that "Standard Oil's efficiency made the company extremely successful: it kept its costs low and was able to sell more and more of its refined product, usually at a lower and lower price, in the open marketplace."²² Unable to compete with Rockefeller's efficiency, a parade of entrenched and obsolete businesses appeared before Congress complaining that "I lost everything I had"; that "it is utterly impossible for anyone to attempt to compete with them"; and that Standard Oil intentionally set its prices "below the cost of manufacturing for the purpose of destroying the competitor."²³

The predecessors to modern "public interest" groups were muckraking journalists such as Ida Tarbell, who published a blistering exposé on Standard Oil in 1904. Tarbell incited public outrage, warning

that “the whole extent of the evil that may be done to producers, refiners, dealers and consumers, and to the public generally, if this corporation—or rather combination of corporations—is successful, is so deep and varied and far reaching, that it cannot be fully comprehended.”²⁴ As the public pressure built, Roosevelt in 1906 launched what DiLorenzo calls “a vindictive political assault on [Rockefeller’s] company for the ‘sin’ of rapid innovation, a vast expansion of production and rapidly declining prices.”²⁵

The Standard Oil case established the philosophy governing all ensuing antitrust enforcement. Even though Supreme Court Justice Oliver Wendell Holmes confessed privately that “I don’t disguise my belief that the Sherman Act is a humbug based on economic ignorance and incompetence,”²⁶ he supported the court’s decision in 1911 to break up Standard Oil. This ruling established the “rule of reason,” giving judges and bureaucrats authority to interpret the Sherman Act according to their arbitrary view of “good” and “bad” competition.

Roosevelt’s successor, William Howard Taft, exercised this authority with abandon, declaring that even if it “may make business halt,” “we are going to enforce that law or die in the attempt.”²⁷ The result was a chaotic, subjective, and inconsistent jumble of Sherman Act interpretations. To impose a semblance of order on antitrust enforcement, Woodrow Wilson in 1914 signed the Clayton Act, described by University of Wisconsin historian John Milton Cooper as “a lengthy, detailed, tightly drafted statute that specified prohibited business practices, such as combinations to allocate and control markets, and prescribed penalties and remedies for infringements.”²⁸

To ensure consistent and predictable implementation of competition policy, Wilson also created the Federal Trade Commission (FTC). By placing authority in the hands of regulators, Wilson hoped to supplant the whimsical decisions of politicians and judges with the reasoned deliberation of qualified experts. Arguing before Congress, he declared that the FTC would help make “the menace of legal process in these matters” more “explicit and intelligible” by providing “the advice, the definite guidance, and information which can be supplied by an administrative body.”²⁹

According to historian Martin J. Sklar, Wilson’s actions “settled the trust question” and established “the sustained basis for all subsequent national anti-trust policy.” “Never again,” Sklar continues, “would the trust question as such lie at the center of major party politics. At last, in short, the trust question was ‘taken out of politics.’”³⁰

OBSOLETE LAWS FROM A BYGONE ERA
THREATEN TO HAMSTRING THE DEVELOPMENT
OF NEW TECHNOLOGIES.

Removing the trust question from politics, however, did not remove politics from the trust question. Wilson did not eliminate the vast executive authority to prosecute businesses through the Department

of Justice (DOJ), or the freedom of judges to offer wildly inconsistent and incompatible interpretations of the law. Instead, he created a second executive body for antitrust enforcement, consisting of unelected regulators. This only widened the playing field for lobbyists and special interests hoping to game the system through political influence.

As politicians and regulators invoke the clumsy machinery of government to control the rapidly growing machinery of innovation, obsolete laws from a bygone era threaten to hamstring the development of new technologies. The legacy of antitrust enforcement is a corrupt, erratic, and heavy-handed system ill-equipped for sustaining America's competitiveness in the digital age.

Nobody Passes “Go” When Government Plays Monopoly

Antitrust arose as a purely political construct with no basis in economic theory. Politicians and special interests, therefore, required a new theory to justify the manipulation of private commerce. To satisfy this need, they embraced the concept of “perfect competition.” As explained by economists David Evans and Richard Schmalensee, “perfect competition is to economics what the frictionless plane is to physics: an abstract ideal that is never attained in reality.” Regardless, Evans and Schmalensee continue, deviations from this unattainable ideal are often interpreted as “signs of possible competitive problems that may warrant government intervention.”³¹

This theory provides a convenient justification for imposing limitless penalties on any company for any reason. Special interests exploit this broad authority to shape markets artificially in their favor. Ironically, those who invoke antitrust to hobble competitors are themselves guilty of restraining competition and should also be subject to antitrust scrutiny. Fortunately for corporate lobbyists, however, the Supreme Court granted an exemption in 1965, declaring that “efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition.”³²

Therefore, antitrust has become a tool for firms to eliminate competitors in the name of promoting competition. Even some regulators are dismayed by the disingenuous and blatantly anti-competitive behavior inspired by antitrust. According to former FTC Chairman Deborah Platt Majoras, shrewd lobbying tactics are blurring the line between “aggressive antitrust advocacy and pure lobbying in the political sense.” Ruthless competitors, Majoras explains, “are making use of lobbyists and PR firms to try to influence our enforcement decisions, not necessarily on the merits, but through the media, lobbying Congress and, yes, through attempts to lobby us.”³³ As a result, successful companies face a bewildering barrage of politically motivated antitrust charges.

ANTITRUST HAS BECOME A TOOL FOR FIRMS
TO ELIMINATE COMPETITORS IN THE NAME OF
PROMOTING COMPETITION.

The Cato Institute’s Robert Levy describes the absurd challenges faced by legitimate businesses when “conduct that is otherwise legal somehow morphs into an antitrust violation. . . . When they are not accused of monopoly price gouging for charging too much, companies are accused of predatory pricing for charging too little or collusion for charging the same!”³⁴

NO COMPANY IS SAFE FROM THE THREAT
OF PROTRACTED AND EXPENSIVE
ANTITRUST LITIGATION.

Under this “can’t win” scenario, no company is safe from the threat of protracted and expensive antitrust litigation. Dissenting in a 1966 Supreme Court decision, Justice Potter Stewart expressed frustration over the government’s arbitrary and punitive competition policy: “the sole consistency that I can find is that . . . the government always wins.”³⁵

Piñata Politics: Antitrust Lets Everyone Take a Whack

For lobbyists, lawyers, and politicians seeking to shape the market for personal gain, Washington is only the first stop on an international journey. The influx of money, power, and influence that antitrust generates has become the envy of governments around the world. In 1976, Congress spread the wealth within the United States, granting every state (and the District of Columbia) the authority to enforce federal antitrust law. As a result, armies of lobbyists roam from state to state in search of friendly attorneys general willing to prosecute competitors and eager to bask in the publicity of bringing a multinational corporation to its knees. Separate suits can be brought at the state and federal level, allowing rivals to recycle the same charges endlessly in multiple venues in order to persecute successful firms.

During his 27-year tenure on the Seventh Circuit Court of Appeals, Judge Richard Posner has witnessed the disastrous consequences of granting vast antitrust power to 53 autonomous entities—50 states, the District of Columbia, the Department of Justice, and the FTC. As Posner puts it, “I would like to see, first, the states stripped of their authority to bring antitrust suits,” because states “are too subject to influence by interest groups that may represent a potential antitrust defendant’s competitors. This is a particular concern when the . . . competitor, who is pressing his state’s attorney general to bring suit, is a major political force in that state.”³⁶

If a company survives attacks from state and federal regulators, competitors can coax foreign governments to join the fray. Economists Eric Crampton and Donald Boudreaux explain how in the digital age, every company is “now a mouse click away from every jurisdiction in the world.” New technologies could be thrown into disarray, Crampton and Boudreaux continue, when “the litigating jurisdiction is capable of enforcing its remedies on firms outside its borders.” The prospect of obtaining control over global commerce has triggered a race to the bottom, where every country fights to impose the most draconian regulations because “the ruling of the most restrictive jurisdiction is likely to prevail.”³⁷

The contest to become the global regulator of e-commerce is underway. According to the United Nations Conference on Trade and Development (UNCTAD), 113 countries have adopted national competition policies or are in the process of developing them.³⁸ These countries can consult the International Competition Network (ICN), a virtual antitrust society formed in 2001. However, the ICN provides only non-binding, general advice; it does not deter countries determined to abuse antitrust laws in order to advance national interests.

IF A COMPANY SURVIVES ATTACKS FROM STATE AND FEDERAL REGULATORS, COMPETITORS CAN COAX FOREIGN GOVERNMENTS TO JOIN THE FRAY.

The worldwide spread of antitrust policies led former DOJ antitrust chief Charles James to remark that “antitrust has been one of the United States’ most successful exports.”³⁹ Like a boomerang, however, this export returns with a vengeance when foreign governments use competition laws to cripple American companies.

Even after fending off harassment from two federal authorities, 50 states attorneys general, and 113 foreign governments, companies have only witnessed the tip of the antitrust iceberg. Under the Clayton Act, any private parties who claim to have suffered from lack of “competition” can bring suit in civil court. Therefore, any company whose products fail to compete successfully in the marketplace can use the courts to compensate for its own shortcomings. If the court sides with the plaintiff, it is entitled to collect threefold damages from its successful competitor. This provides a substantial incentive for failing businesses to bypass consumers and keep unpopular products afloat through litigation.

According to Fred McChesney, “for every case brought by government, private plaintiffs bring twenty.” Many of these suits, McChesney explains, stem from “the desire to hobble the defendant’s efficient practices,” because “competitors are hurt only when a rival is acting procompetitively by increasing its sales and decreasing its price.”⁴⁰ As a result, private antitrust lawsuits punish the practices that most benefit consumers. Worse, resources spent defending these practices in court are siphoned from research and development, creating a significant drag on the pace of innovation.

Economists William Baumol and Janusz Ordover explain that when competitors battle to advance their interests in the courtroom rather than the market, “they will benefit neither the plaintiff nor the defendant, while raising the cost to society.” This battle to restrict competition in the name of protecting competition creates what Baumol and Ordover call “an enchanted topsy-turvy world in which vigorous competition is made to seem anticompetitive and in which ‘fair competition’ comes to mean no competition at all.”⁴¹

Alan Greenspan summarizes the perverse incentives created by antitrust as “reminiscent of Alice’s Wonderland: everything seemingly is, yet apparently isn’t, simultaneously. It is a world in which com-

petition is lauded as the basic axiom and guiding principle, yet ‘too much’ competition is condemned as ‘cutthroat.’ It is a world in which actions designed to limit competition are branded as criminal when taken by businessmen, yet praised as ‘enlightened’ when initiated by the government.”⁴²

Competitors deploy the multiple layers of antitrust enforcement to smother dominant firms and restrain innovation. By artificially protecting inferior products, antitrust limits the rise of new ideas, inventions, and strategies. It thus not only restricts competition between companies, but also handicaps America’s ability to market competitive technologies in an increasingly global information economy. If these obsolete and ineffective restrictions continue to limit the freedom to create, the next wave of innovation in the digital revolution will crest overseas.

The Cybertrust Illusion: Antitrust in the Digital Age

Technology has always moved faster than the law. Even the term “antitrust” betrays the futility of creating laws to control innovation. As historian Ross Evans Paulson notes, by the time Congress passed the Sherman Act,

IN THE DIGITAL AGE, HOWEVER, MONOPOLIES
ARE ONLY FLEETING ILLUSIONS.

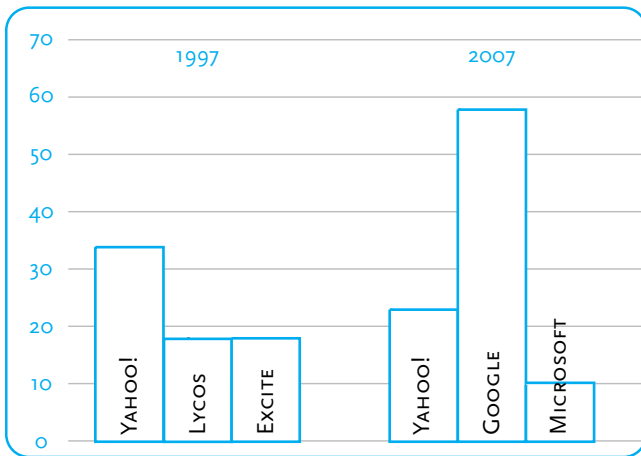
“the trust *per se* as an innovation in corporate form was already obsolete.”⁴³ This 118-year-old law is particularly inadequate to keep pace with rapidly developing 21st-century technologies. Antitrust laws are based on the assumption that large firms with entrenched market dominance cannot be displaced without government intervention. In the digital age, however, monopolies are only fleeting illusions.

For example, when the Johnson administration launched an antitrust investigation against IBM in 1969, the company controlled 60 percent of the computer market. Today, the once-dominant computer maker captures only 4.5 percent of the market.⁴⁴ Was government intervention required to facilitate the entry of new competitors? After 13 years and millions of dollars spent scrutinizing IBM’s business practices, the government dropped its case without imposing any remedies. According to Domenick Armentano, “Assistant Attorney General William Baxter understood the true state of affairs when, in 1982, his office withdrew its absurd legal action, terming it ‘without merit.’”⁴⁵ IBM’s dominance declined because of the spontaneous rise of creative new competitors, not through arbitrary government manipulation.

In the technology sector, dominant firms must constantly evolve and innovate to remain successful. Because change occurs rapidly and unpredictably through successive revolutions, neither regulators nor monopolists can anticipate or control how the market will evolve. Joseph Schumpeter coined the term “creative destruction” in 1942 to describe this “process of industrial mutation that incessantly revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one.”⁴⁶ Therefore, even though a company may briefly emerge victorious in a revolution of creative destruction, it is nearly impossible for this company to forestall the next revolution.

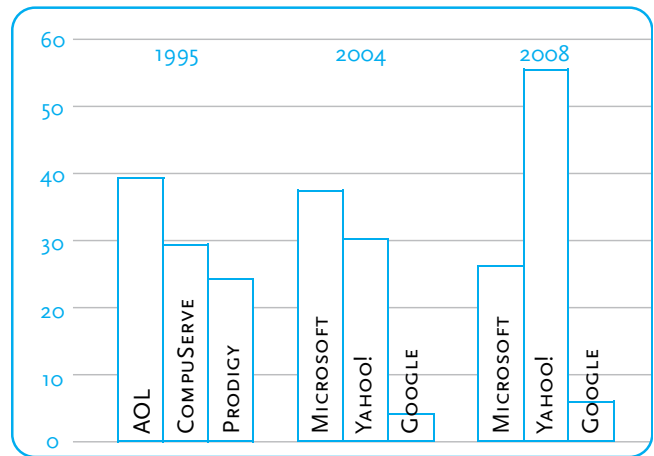
The Internet has dramatically increased the likelihood and frequency of creative destruction. The rapid flow of information online enables new startups to achieve exponential growth in popularity with only minuscule initial investments. As Evans and Schmalensee put it, a creative idea is the only “critical asset in new-economy industries,” meaning that “entry costs can be quite low, and the risk that a dangerous rival will emerge seemingly from nowhere can be quite high.”⁴⁷ As shown in Figure 1, if a leading technology firm becomes complacent, nimble and innovative competitors will launch a barrage and quite possibly sink the company.

Figure 1a: Search Engine Market Share



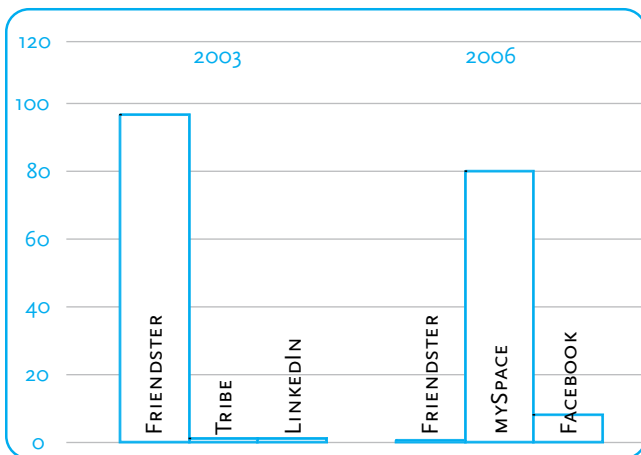
Source: comScore Media Metrix.

Figure 1b: E-mail Providers' Market Share



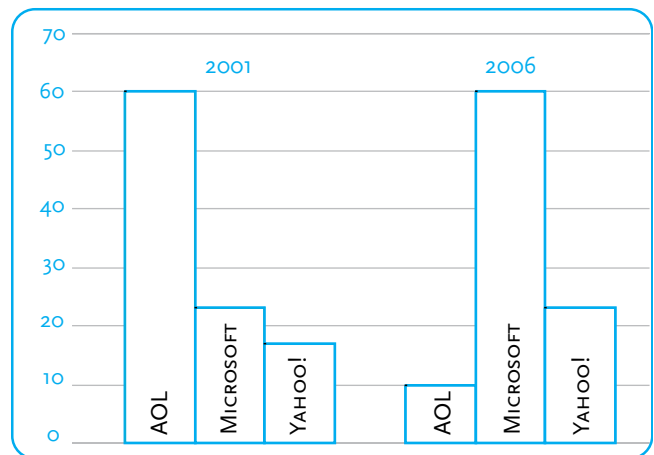
Sources: Jupiter Communications, see Julie Pitta, “Online Operators Gear Up for the Microsoft Network Onslaught,” *Los Angeles Times*, May 31, 1995, Radicati Group, Hitwise.

Figure 1c: Social Networking Market Share



Sources: Jim Hopkins, Investors Court Social-Networking Sites, *USA Today*, December 9, 2003 (online dating sites excluded), Hitwise, June 2006.

Figure 1d: Instant Messaging Market Share



Source: comScore, November 2001 and May 2006, Percentage of Total Unique IM Users.

The Internet creates a rapidly evolving ecosystem of innovation which naturally resists enduring monopolies. To allow this atmosphere to thrive, regulators must suppress the impulse to regulate market leaders—they must avoid the “cybertrust illusion.” The history of the technology sector proves that it is both futile and counterproductive to continue using policies designed for the obsolete business models of a bygone era.

THE INTERNET CREATES A RAPIDLY EVOLVING ECOSYSTEM OF INNOVATION WHICH NATURALLY RESISTS ENDURING MONOPOLIES.

For example, as of 1997 Yahoo! dominated the Internet search market, possessing enormous power to control how consumers browse, shop, and interact online (see Fig. 1a). The company’s perceived strength was so established that, when Hasbro introduced a new edition of its MONOPOLY board game in 2000, it characterized Yahoo!, Lycos, and Excite as a “web portal monopoly” and the keystone of a new “cyber empire.”⁴⁸ By 2007, however, two of these players had disappeared, and Yahoo! possessed less than half the market share of its closest competitor. This rapid flux in market conditions was a natural consequence of creative destruction, not an artificial solution imposed by regulators. Unlike the government-sheltered railroad monopoly depicted in the original MONOPOLY game, Internet companies enjoy no protection from innovative entrepreneurs or transformative new technologies.

Yahoo! lost its leading position in the Internet search market to a new competitor boasting a superior product. Google’s 10-year rise from a garage-based college project to a \$150-billion company demonstrates that there are few barriers on the Internet to prevent a startup from succeeding on its merits. As explained by Congresswoman Anna Eshoo, a Democrat from Silicon Valley, “Google had invented the better mousetrap . . . This is not only the story of Google, it’s the story of Silicon Valley and the Internet—brilliant innovators with groundbreaking ideas and the entrepreneurial spirit to bring them to the world.”⁴⁹ On the Internet, a company’s closest competitor is only a mouse click away. No firm can act to block competition, and consumers rapidly migrate to the best products, services, and technologies.

In many cases, creative destruction results from a dramatic advance in technology capable of transforming the entire market and bringing down even the most entrenched players. The earliest e-mail providers, AOL, CompuServe, and Prodigy, once dominated the market by locking users into subscription-based online services (see Fig. 1b). The introduction of free Web-based e-mail facilitated a dramatic migration away from these closed online communities. New technologies enabled users to access the Web directly, leading Gary Wolfe to declare in *Wired* in 1994, “Don’t look now, but Prodigy, AOL, and CompuServe are all suddenly obsolete.”⁵⁰ A new group of dominant e-mail providers, offering Web-based interfaces, rose up to take their place, though all of these companies could be carried away by the next unpredictable wave of innovation.

The recent introduction of interactive services, such as social networking, only further accelerates the pace of creative destruction. These sites create personalized communities and provide

a powerful platform for users to collaborate, share, and create. Under traditional models of anti-trust enforcement, networks are typically targeted for especially harsh treatment. According to Joel Klein, the Clinton administration's top antitrust official, regulators considering new technologies must be vigilant against "network effects." "What this fancy jargon means," Klein explained, "is something we all tend to understand intuitively: in certain circumstances, nothing succeeds like success. A network effect occurs when the more a business sells of a particular product or service, the more people want it because its increasing adoption increases its value to the next user."⁵¹ In other words, networks are "winner take all," because users migrate to the service that boasts the most subscribers.

Klein warned that these businesses must be preemptively regulated because "once a network gets a sufficiently large number of customers, it becomes almost impossible for a new entrant without access to the network to successfully challenge its dominance."⁵² In fact, on the Internet, the exact opposite

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is true: as networks amass users, they become increasingly vulnerable to dramatic collapse at the hands of a new competitor. This phenomenon, best described as the "social network effect," occurs because each user who abandons a leading network takes with him his virtual community of friends and contacts. The result is that an innovative new player rapidly rises, and the displaced front-runner suffers a sudden exponential decline. In the social networking market, for example, the first company to popularize this new technology, Friendster, dropped from complete market dominance to less than 0.5 percent of total market share in less than three years (see Fig. 1c).

For technology entrepreneurs and innovators, "premerger review" is the most dreaded tool in the antitrust arsenal. In 1976, Congress passed the Hart-Scott-Rodino Act, requiring large mergers to receive approval from both the DOJ and the FTC before the transaction can proceed. Regulators can challenge a merger for nearly any reason, and they can drag out this process for months or years. Because of the rapid pace of innovation and the frequency of creative destruction, even modest stalls and uncertainty in a company's business strategy can inflict irreversible damage.

The Hart-Scott-Rodino Act provides little incentive for regulators to exercise their premerger review authority sparingly. Because the DOJ and the FTC are directly funded by "filing fees" from the companies they regulate, this legislation actually encourages excessive antitrust enforcement. As explained by Skip Oliva, president of the Voluntary Trade Council (VTC), a market-oriented research and educational center, "the government is forcing businesses to pay for the very antitrust enforcement that is targeted directly against their interests. This is a classic racketeering scheme. A business is forced to pay protection money to a thug who could turn against them at any time."⁵³

The government, therefore, is often a willing participant when firms provoke extended premerger review to thwart their leading competitors. The result is a massive regulatory apparatus that burdens successful firms in order to ensure its own self-preservation.

According to the final report of the Antitrust Modernization Commission (AMC), a panel of experts impaneled by Congress in 2002, companies today must spend \$3.3 million to navigate the premerger process. This includes “583,000 pages of email and 555,000 pages of other documents; 275 pages of interrogatory responses; 13 gigabytes of electronic data; \$2.4 million in fees for attorneys; and \$300,000 in fees for economists.”⁵⁴

THE GOVERNMENT, THEREFORE, IS OFTEN A WILLING PARTICIPANT WHEN FIRMS PROVOKE EXTENDED PREMERGER REVIEW TO THWART THEIR LEADING COMPETITORS.

Companies must endure this extortion to avoid the prospect of an even costlier and lengthier legal challenge. As the AMC concluded, “the delay, uncertainty, and potential bar that a challenge would cause leads the parties to meet almost any agency demand in order to avoid going to court.”⁵⁵ Further, countries throughout the world are establishing their own premerger review protocols to partake of the benefits of extorting America’s innovators.

In the global technology marketplace, any jurisdiction has the authority to challenge a merger and hamstring a company’s business strategy indefinitely. The European Union (EU) bans any merger resulting in “the creation or strengthening of a dominant position.”⁵⁶ Assuming that companies do not willingly merge with the intent of *weakening* their market position, the EU regulations apply to nearly every merger between successful firms. In 2001, the European Commission (EC) claimed the authority to override the DOJ and FTC, blocking the merger of two American companies, General Electric and Honeywell. Even though American regulators had already approved the transaction, European Competition Commissioner Mario Monti exerted his right arbitrarily to thwart global business decisions that could hypothetically “lead, eventually, to reduced consumer welfare.”⁵⁷

In August, 2008, a new “Anti-Monopoly Law” will go into effect in the People’s Republic of China. As China’s meteoric growth conflicts with U.S. economic interests, this antitrust law could become a powerful weapon for protecting state-run businesses and eliminating American competitors. According to Christopher Padilla, the U.S. under secretary of commerce for international trade, Chinese regulators “routinely treat foreign firms more harshly than domestic ones” and “redirect the market with price controls and quotas.” It is, therefore, to be expected, Padilla continues, that China will apply a double standard for antitrust that may “exempt Chinese state-owned firms from the disciplines of competition rules.”⁵⁸

In a global digital marketplace, the expansion of premerger review will ultimately give any nation the power to veto foreign business decisions. Companies seeking to adapt to rapidly developing technolo-

gies could be forced to navigate hundreds of subjective policies and protectionist political interests. The VTC's Skip Oliva explains that this "would grind the entire American economy to a halt. Telling businesses not to merge would be like telling humans not to breathe; we're dealing with an essential element of capitalism here, not an optional appendage."⁵⁹

The rapid pace of creative destruction in the technology sector ensures that no merger can truly threaten consumer welfare. Premerger review, however, allows bureaucrats driven by special interests and protectionist motives to sequester leading innovators in a purgatory of regulation. This process harms consumers by delaying or blocking the introduction of creative new products. For example, in 2000, when America Online and Time Warner announced plans to merge, the companies combined were worth \$160 billion. After a year of intense premerger scrutiny, this value had fallen more than 30 percent, leading an article in the *Guardian* to proclaim that "the threat of world domination once presented by AOL Time Warner has seriously faded."⁶⁰

Rivals of AOL seized upon the premerger process to help stall the company's growth and gain unfair advantages in the marketplace. Once the door has been opened to antitrust scrutiny, competitors can deluge regulators with complaints, even if they are unrelated to the merger. For instance, Time Warner's assets would not benefit AOL's popular instant messaging (IM) service; however, competing IM providers argued for regulatory barriers that would handicap AOL's product. According to one rival, "Allowing AOL to merge with Time Warner will only increase its ability to dominate and restrict customers' freedom of choice in instant messaging . . . Bullies are bullies and getting bigger rarely makes them more responsible."⁶¹

In addition to lobbying the two existing U.S. antitrust agencies, AOL's competitors argued that the Federal Communications Commission (FCC) also holds premerger review authority for any transaction that involves the Internet. Because regulators rarely decline an opportunity to expand their own powers, a majority of FCC commissioners readily embraced these arguments. In a blistering dissent, FCC Chairman Michael Powell explained that the commission's decision was based on "collective imaginations," and confers "jurisdiction to regulate virtually every Internet product or service." "Such interference," Powell warned, "would undermine the energy and drive toward innovation that characterizes these highly competitive markets."⁶²

The FCC approved the merger, but it imposed restraints on AOL's IM business to help competitors gain market share. One commissioner insisted that without these conditions, "the largest network will continue to grow at the expense of the smaller networks . . . not necessarily because it charges the lowest prices, offers the best quality or offers innovative features that customers want, but simply because in the past it gained the most users."⁶³ The FCC, like all regulators who attempt to shape the path of technology markets, had fallen victim to the cybertrust illusion.

Before AOL could even implement the FCC's order, the market began to shift dramatically. AOL's dominance in IM services quickly eroded (see Fig. 1d), and the FCC recognized the futility of attempting to regulate such fluid markets. It quietly lifted its restrictions, noting that "AOL's market share experienced a precipitous decline" and that "the condition in question no longer serves the public interest, convenience, or necessity."⁶⁴ Chairman Powell concluded that the entire case amounted to "regulation for the sake of regulation with no clear purpose or public interest value."⁶⁵

Despite the evidence that consumers benefit from creative destruction in the absence of regulation, why do regulators continue to embrace the cybertrust myth? Many regulators and lawmakers possess only a shallow understanding of new technologies, and, therefore, frequently turn to industry lobbyists for guidance. After the Justice Department sued Microsoft in 1998 (see next section), these lobbyists quickly realized that the government was an ignorant, vulnerable, and powerful force, ripe for manipulation.

THESE LOBBYISTS QUICKLY REALIZED
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This realization confronted innovators with a dilemma: lobby or don't lobby? For the industry as a whole, it would be counterproductive to funnel money away from research to fund political operations. For an individual firm, however, it would be irresponsible to avoid these activities if its competitors are all actively exploiting the government. As explained by economists Jeffrey Clark and Dwight Lee, this is a "prisoner's dilemma" situation, "where the behavior that is rational for the entire group is irrational from the perspective of each individual in the group." Therefore, even though "the best outcome is for neither group to seek political advantages," it is in the best interest of each firm individually "to behave noncooperatively by lobbying."⁶⁶ This prisoner's dilemma leads technology companies to lobby for excessive and punitive use of antitrust laws against their competitors. The only solution to this dilemma—an agreement among firms to curtail antitrust lobbying—would itself be regarded as an example of collusion and a violation of antitrust law.

Only one year after the DOJ began its Microsoft prosecution, the technology sector had established a powerful political presence. Recognizing this growing influence, a 1999 article in *Fortune* declared that "not since the Robber Barons bought their way to power has a group of corporate executives held as much sway in Washington as the high-tech titans."⁶⁷ As shown in Figure 2a, total lobbying expenditures in the technology sector have risen dramatically, doubling between 2000 and 2006. Today, computer and Internet firms spend more on lobbying than any other industry except pharmaceuticals, insurance, and electric utilities.⁶⁸

Eager to exploit the government's expansive powers under antitrust law, technology companies increasingly employ lobbyists to handicap competitors in the name of "competition." This lobbying results in "regulatory

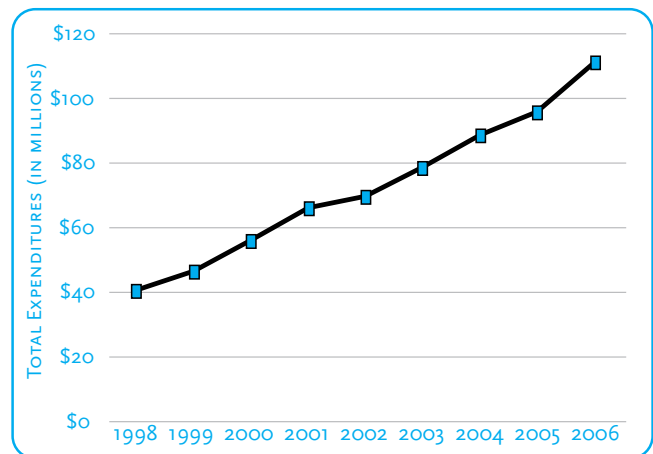
capture,” defined by Richard Posner as a situation where, “over time, regulatory agencies come to be dominated by the industries regulated.”⁶⁹ Small and struggling companies urge regulators to take down their dominant competitors. Once these companies achieve success, however, they must reverse course and argue against antitrust scrutiny of their own practices. The ensuing fight resembles a self-serving game of “hot potato,” where firms never hesitate to invoke antitrust against competitors but vehemently oppose these same laws when the potato lands in *their* lap.

Dominant firms have accepted that in the current antitrust framework, continued success requires a substantial and sustained investment in regulatory appeasement. Microsoft general counsel Brad Smith acknowledged in February, 2008, that the company must now tailor its business decisions to “reflect the changed legal landscape for Microsoft and the information technology industry.”⁷⁰ Other large companies have come to the same conclusion. As a result, the 10 leading technology firms have increased the number of antitrust lobbyists on their payroll by 60 percent since 2000 (see Fig. 2b).

Of far greater concern is the rapid rise in antitrust lobbying by smaller, competing firms. Since 2000, these companies’ lobbying operations have grown 15-fold (see Figure 2b). While antitrust lobbying was once predominantly a defensive tactic for successful firms, the technology sector has transformed this practice into an aggressive maneuver for smaller competitors. Today, even small startups rely on antitrust lobbying, rather than innovation, to sabotage popular firms and gain a foothold in the market.

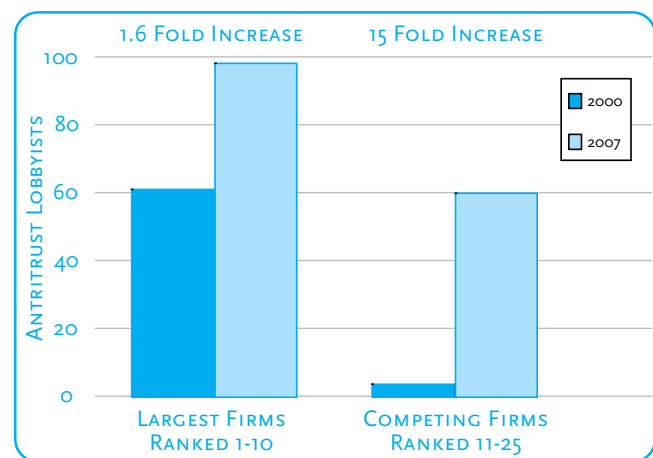
CONTINUED SUCCESS REQUIRES A SUBSTANTIAL AND SUSTAINED INVESTMENT IN REGULATORY APPEASEMENT.

Figure 2a: Annual Lobbying in Technology Sector



Source: Center for Responsive Politics, OpenSecrets.org Lobbying Database, Computers/Internet Sector (excludes telecommunications)

Figure 2b: Antitrust Lobbyists for Top 25 Technology firms 2000-2007



Source: Top firms were analyzed according to position in Fortune 500 rankings for 2000 and 2007. Total number of antitrust lobbyists was determined by examining filings with the Senate Office of Public Records for specific lobbying issues including antitrust, competition, mergers, and acquisitions.

The increasing manipulation of antitrust laws to impede rivals and limit competition not only restricts innovation, but provides no benefits for the consumer. To hide this fact, companies often create and secretly fund phony “grassroots” organizations, which confuse the public and create the appearance of broad popular support. This practice, referred to as “astroturf lobbying,” is defined by *Campaigns & Elections Magazine* as any corporate-funded “grassroots program that involves the instant manufacturing of public support for a point of view in which either uninformed activists are recruited or means of deception are used to recruit them.”⁷¹

The skyrocketing abuse of antitrust threatens to slow the pace of innovation and harm the competitiveness of America’s technology leaders. Though this abuse has accelerated over the past five years, the situation confronting policy makers today has been foreseeable for more than two decades. In 1985, William Baumol and Janusz Ordover warned that “there is a specter that haunts our antitrust institutions. Its threat is that, far from serving as the bulwark of competition, these institutions will become the most powerful instrument in the hands of those who wish to subvert it. . . . This is a specter that may well dwarf any other source of concern about the antitrust processes. We ignore it at our peril.”⁷²

Rather than heed this warning and avoid expanding the reach of antitrust to rapidly evolving technologies, regulators and policy makers have not resisted the impulse to manipulate markets. Not only does this manipulation fail to benefit consumers, but it results in tangible and lasting harm. Even the nation’s top antitrust regulator expresses little confidence that the government can create competition in high-tech markets. William Kovacic, who became chairman of the FTC in March, 2008, once painted a grim picture of antitrust enforcement: “This isn’t laser surgery, with a doctor operating in an antiseptic environment with an MRI to spot the problem. This is more like a World War I field hospital with hacksaws and chloroform. The judgments are much more crude and subject to error.”⁷³

As competition “surgeons” around the world prepare to operate on high-tech markets, they should consider Chairman Kovacic’s comparison. Much like World War I field medics, antitrust regulators may act with benevolent intent, but the patients often die from infection. When regulators subject advanced technologies to hacksaws and chloroform, the cure is often far worse than the disease.

WHEN REGULATORS SUBJECT ADVANCED TECHNOLOGIES TO HACKSAWS AND CHLOROFORM, THE CURE IS OFTEN FAR WORSE THAN THE DISEASE.

The following case studies demonstrate that antitrust is no longer a bump in the road faced by creative firms on the path to success. Instead, it is becoming a brick wall for innovation. Because regulators and less successful competitors both profit from the abuse of antitrust, they readily cooperate to extort leading firms. If companies must avoid success in order to prevent crippling extortion, consumers will be deprived of popular products, and the pace of competition, creation, and digital innovation will grind to a halt.

MICROSOFT: Opening Doors by Breaking Windows

“The whole Internet is part of the conspiracy to get Microsoft.”⁷⁴
—Larry Ellison, co-founder and CEO, Oracle

“Those who can, do. Those who can’t, consort.”⁷⁵
—Scott McNealy, CEO, Sun Microsystems

Microsoft’s Competitors Master the Game of DOJ-Ball

In 1998, the Department of Justice (DOJ), 19 states, and the District of Columbia launched a landmark antitrust case against Microsoft. After an 18-month trial, costing taxpayers \$13.3 million,⁷⁶ and a two-and-a-half-year settlement process, the company was placed under strict government oversight, which continues to this day and was recently extended until November 12, 2009. The government’s prosecution of Microsoft marked the first major application of antitrust in the Internet age. No longer would high-tech innovators enjoy the freedom to create and succeed without the constant threat of government interference.

Prior to this case, most technologists saw little need to hire lobbyists or maintain a Washington presence. Microsoft Chairman Bill Gates boasted in 1995 that “we thrived during our first 16 years without any of this. I never made a political visit to Washington, and we had no people here. It wasn’t on our radar screen. We were just making great software.”⁷⁷ There was little reason to believe that the government would fall victim to the cyber-trust illusion and attempt to manipulate rapidly evolving technologies. Judge Thomas Penfield Jackson, who presided over the Microsoft trial, had once proclaimed that “there is no doubt in my mind that Microsoft is a unique, gifted, efficient, and ingenious organism.”⁷⁸ The Clinton administration embraced the promise of unfettered innovation in the high-tech sector. Robert Shapiro, Clinton’s undersecretary of commerce for economic affairs, declared that the administration would

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change “the way we have been thinking about antitrust in light of the way we understand how markets operate in a global economy,” and he pledged to protect the “incentives to be more productive and more innovative.”⁷⁹

In this pro-innovation climate, how did Microsoft wind up in the Justice Department’s crosshairs? Behind every cybertrust illusion lies a cybertrust conspiracy. Microsoft’s dominance in the PC software market had inspired envy and animosity among the company’s leading rivals. Unable to create a successful alternative to Windows, these competitors secretly conspired to deploy the government against their common foe. In 1998, the *Wall Street Journal* remarked that “this anti-Microsoft cabal represents an experiment in mutual cooperation against a single enemy that may be unprecedented in modern American industry.”⁸⁰

Investors and consumers alike would disapprove of this plot, so conspirators vowed to collude in secret. According to John Heilemann’s award-winning exposé in *Wired*, Jim Barksdale, the CEO of Netscape (a key Microsoft competitor in the web browser market), expressed fear that if the plot became public “people would read it as the whinings of some sad-sack loser. What would the markets think if we said, ‘Well, if the government doesn’t help us, we’re doomed?’”⁸¹ The motivation behind this conspiracy was not to benefit consumers by enhancing competition. According to Netscape’s co-founder, Marc Andreessen, the company intended to reduce Windows to “a poorly debugged set of device drivers.”⁸²

The anti-Microsoft coalition became known as NOISE (Netscape, Oracle, IBM, Sun, and Everybody else). When the plot was hatched in 1996 to enlist the DOJ against Microsoft, revenues reported by the named NOISE members eclipsed Microsoft’s by nearly 14-fold.⁸³ Rather than leverage this \$75-billion advantage to design a superior, competing PC operating system, these rivals lobbied regulators to dismantle the market’s leading product. Netscape’s Jim Barksdale recognized the power of government to “help or hinder the technology industry” and concluded that it made little sense to compete fairly through innovation when “working with the government is far more productive.”⁸⁴ This “working” relationship even included a private breakfast at Barksdale’s Palo Alto home with the DOJ’s chief antitrust official, assistant attorney general Joel Klein.⁸⁵

The conspiracy had its own secret code name: “Project Sherman,” a reference to the Sherman Antitrust Act. As John Heilemann revealed, NOISE assembled “a superstar group of antitrust authorities” paid for by Sun Microsystems. It was important to conspire “in utmost secret,” Heilemann continues, because “here was one of Microsoft’s most ardent competitors bankrolling a costly endeavor to influence the DOJ.” The irony of this situation is a testament to the absurd and arbitrary enforcement of antitrust law: the Sherman Act forbids “restraint of trade,” yet in this case a plot, named after the Sherman Act, was hatched to enforce the Sherman Act, by conspiring in violation of the Sherman Act.

This is a prime example of how antitrust encourages anticompetitive behavior in order to punish competitive behavior. Without fear of government scrutiny, the NOISE conspirators engaged in ruthless and brazen tactics. Oracle CEO Larry Ellison even hired a former Watergate investigator to sift through Microsoft's trash. When confronted about this anticompetitive act of corporate espionage, Ellison proudly proclaimed his actions a "civic duty" and a "public service."⁸⁶

ANTITRUST ENCOURAGES
ANTICOMPETITIVE BEHAVIOR IN ORDER
TO PUNISH COMPETITIVE BEHAVIOR.

The lobbying efforts of Project Sherman and its astroturf front group, ProComp, caused regulators to lose perspective about the fundamental nature of markets, competition, and innovation. This exasperated Bill Gates, who struggled to combat these distractions: "Look, look, this is called capitalism! We create a product called Windows. Who decides what's in Windows? The customers who buy it." Unfortunately for Gates, however, Joel Klein had already fallen for the cybertrust illusion: "We reject categorically the notion that markets will self-correct and we should sit back and watch."⁸⁷

Under Klein's direction, the Justice Department resolved to prove that "Microsoft is a monopolist and it engaged in massive anti-competitive practices that harmed innovation and limited consumer choice."⁸⁸ To accomplish this, the DOJ hired a lead attorney who, according to the *Seattle Times*, "doesn't know how to use a computer" and "has never browsed the Internet."⁸⁹ The case would be decided by a judge who viewed the trial's central issues as "esoteric topics for which I have no background."⁹⁰ Fortunately for Judge Thomas Penfield Jackson, however, a parade of anti-Microsoft conspirators gladly volunteered to provide "expert" testimony. Summarizing the trial, a *New York Times* article noted that "witness after witness—an executive roll-call of companies that drive today's economy, including Intel, I.B.M., Netscape Communications, America Online, Sun Microsystems and Apple Computer—has portrayed the Microsoft Corporation as a bullying monopolist."⁹¹

When the dust settled, competitors had successfully opened doors by breaking Windows. After an initial ruling that Microsoft should be forcibly split, the company eventually acceded to less drastic government demands. The resulting settlement allowed rivals to access the inner workings of Microsoft's operating system and freely market compatible applications. By enabling competitors to treat Microsoft's operating system as if they had developed it themselves, the ruling removed a key market incentive to design competing platforms. Ironically, this attempt to create competition actually obliterated it, cementing the status of Windows as the global standard for operating systems.

It is, therefore, not surprising that in August, 2007, a coalition led by California Attorney General Jerry Brown would find that the settlement had had "little or no discernible impact in the marketplace" for operating systems. Five years after the original ruling, Brown concluded that "Microsoft's share has remained persistently high at supra-monopoly levels."⁹²

Even though the settlement leveled the playing field for innovation on the Windows platform, Microsoft's competitors remained unsatisfied. In a brazenly anti-consumer move, they sought an additional order forcing the company to sabotage its own products. This proposed remedy would have required Microsoft to sell a stripped-down version of Windows lacking popular applications such as its web browser, e-mail client, and media player. Fortunately, U.S. District Court Judge Colleen Kollar-Kotelly rejected this request, recognizing that "certain of Microsoft's competitors appear to be those who most desire these provisions and, concomitantly, are the likely beneficiaries of these provisions."⁹³

FOR RIVALS SEEKING THE STATE-ASSISTED DEMISE OF MICROSOFT, THE EUROPEAN UNION QUICKLY BECAME THE NEW VENUE OF CHOICE.

In the international antitrust game, however, competitors get nearly unlimited bites at the apple. For rivals seeking the state-assisted demise of Microsoft, the European Union quickly became the new venue of choice.

Antitrust EUphoria: Clean Slate, New Rules

As settlement appeared imminent in the United States, the NOISE coalition took its anti-Microsoft lobbying machine overseas. The NOISE companies believed that the EU would prove a much friendlier venue for their complaints, because the European antitrust philosophy is to preserve competition by protecting competitors. This approach values the survival of inferior competitors more than the benefits of successful products. Therefore, regulators see themselves as justified in leveling the playing field by punishing companies whose only crime is achieving success in the marketplace.

Unlike in the United States, there is no trial process for openly debating the merits of rivals' arguments. Instead, a "competition commissioner" and an executive council of unelected bureaucrats (the European Commission) have unilateral authority to investigate and decide antitrust cases. As an article in *Business Week* explained in 2000, "EC trustbusters serve as prosecutor, judge, and jury, and once their verdicts are delivered, appeals must be made to the European Court of Justice, a process that takes two years or more."⁹⁴ All hearings and deliberations take place behind closed doors, making the process highly vulnerable to manipulation by special interests. This vulnerability has attracted an army of foreign lobbyists looking to exploit the EC's regulatory clout.

In October 2007, *Business Week* noted that "Brussels is a lobbyist's dream," where "some 15,000 lobbyists ply their trade . . . vs. the 11,660 who have reported lobbying in the U.S. capital this year." "If you thought Washington was lobbying central," the article concluded, "think again."⁹⁵ It is, therefore, not surprising that Thomas Vinje, a Brussels-based antitrust lobbyist hired by Microsoft's rivals, would declare in 2001 that "if Microsoft is not shaking in its boots then it is misleading itself."⁹⁶

In Europe, Microsoft's fate would be decided by Competition Commissioner Mario Monti, who acquired the nickname Super Mario for his willingness to confront the world's largest corporations. Monti expressed a particular interest in attacking foreign firms, explaining to his European colleagues that antitrust "is the best instrument available in order to ensure that globalization remains a source of welfare for the citizens and the firms in our respective nations."⁹⁷ With the power to fine foreign firms up to 10 percent of their global annual revenue, the EC will collect much of this "welfare" from America's leading innovators.

Microsoft's rivals hoped that European authorities would turn the Windows operating system into a public utility. This would have forced the software maker to sell only the most basic operational product and remove any additional applications that might compete with rivals' offerings. An article in the *New York Times* in 2004 speculated that Windows could become "the functional equivalent of an old-style utility, with extensive government regulation that could even extend into determining what products it sells and at what prices."⁹⁸ Not only would this foist an inferior product on consumers, but it would put the government in charge of approving all future technological innovations, in the same way that it approves upgrades to the electricity grid.

Just as the U.S. antitrust trial became a forum for the self-serving testimony of Microsoft's rivals, the European Commission admitted to secretly amassing an arsenal of evidence from "suppliers and competitors."⁹⁹ Not surprisingly, this charade resulted in a resounding anti-Microsoft judgment. In addition to forcing the company to reveal secrets about its software and levying a \$613-million fine (the largest in EU history), the EC required that consumers must have access to a stripped-down version of Windows lacking its popular media player. Because the EC now viewed Windows as a public utility, it reserved the authority to strip away "any technologies which Microsoft could conceivably take interest in and tie with Windows in the future."¹⁰⁰

Under this precedent, a single unelected European bureaucrat would be given more power over future technologies than all the innovators in the entire world combined. Without any trial or oversight, this bureaucrat can inflict irreversible damage on a company's business model. In cases that survive a prolonged appeals process, European judges have found "several obvious errors, omissions, and contradictions in the Commission's economic reasoning."¹⁰¹ Despite the dangers of giving unchecked authority to unelected regulators, the competition commissioner's power continues to grow. Only one month after rendering his landmark Microsoft verdict, Mario Monti received new powers to block mergers unilaterally, conduct "dawn raids" on businesses, seal corporate offices indefinitely, and even search the homes and cars of executives.

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Regulators in the United States reacted angrily as Monti crowned himself the world's antitrust sheriff. According to DOJ antitrust chief R. Hewitt Pate, the EC's power grab "risks protecting competitors, not competition, in ways that may ultimately harm innovation and the consumers that benefit from it."¹⁰²

The European model of antitrust enforcement completely disregards the needs and interests of consumers. Nothing demonstrates this more clearly than the Microsoft ruling. While Monti believed that consumers would benefit from access to a government-approved, hobbled version of Windows, the public disagreed. Two years after the decision, Microsoft's handicapped operating system without media capabilities had sold only 1,787 copies (0.00005 percent of overall sales).¹⁰³ Unsurprisingly, consumers overwhelmingly opted to purchase the superior product with more capabilities.

Monti's successor, Dutch politician Neelie Kroes, acquired the nickname "Nickel Neelie" for what *Forbes* calls her "take no prisoners dealings with business."¹⁰⁴ After an appeals court upheld the EC's verdict against Microsoft, Kroes sent a stern warning to the company in September, 2007, that "I will not tolerate continued non-compliance."¹⁰⁵ She also made clear that the only way for Microsoft to comply would be to sabotage its own success: "I want Microsoft's market share to diminish to significantly less than 95 percent. I can't say that it has to be precisely 50 percent or whatever number, but it has to be significantly less than 95."¹⁰⁶

A coalition of Microsoft's American competitors, calling itself the European Committee for Interoperable Systems (ECIS), quickly mobilized to help Neelie Kroes achieve her wish. Acting on complaints filed by the ECIS, Kroes initiated two new antitrust investigations against Microsoft in January 2008. The first complaint seeks the free release of information about the inner workings of Microsoft's popular software applications, such as its MS Office suite. Because rivals cannot outcompete Microsoft with innovative products of their own, they claim the right to build on its dominant software as if they had designed it themselves.

Recognizing that this would establish its software as a *de facto* global standard and actually strengthen its monopoly (as had happened with the Windows operating system), Microsoft preempted this complaint by voluntarily releasing all the requested information. Only a week after this sign of cooperation, however, Kroes fined Microsoft an additional \$1.3 billion for not acting quickly enough. Much like the regulators who conduct the premerger review process in the United States, regulators in the European Union directly profit from their antitrust enforcement activities. Therefore, the EC willingly agrees to help rivals handicap dominant firms, and, in exchange, unelected European bureaucrats are able to use successful American innovators as their personal piggy banks.

UNELECTED EUROPEAN BUREAUCRATS
ARE ABLE TO USE SUCCESSFUL
AMERICAN INNOVATORS AS THEIR
PERSONAL PIGGY BANKS.

Unlike the first ECIS complaint, which does not seek to dictate how Microsoft designs and markets its software, the second complaint asks the company to cripple its own products. Just as the EC ordered Microsoft to sell an unpopular version of Windows lacking media capabilities, it could invoke its authority to treat Windows as a public utility and force the company to remove its Internet Explorer browser. If the EC grants this petition, it would be working on the assumption that integrated Internet access is not in the public interest of Europeans. Because Windows would not ship with Internet capabilities, European customers would be forced to order the browser of their choice separately.

Rather than shield Europeans from the Internet, the EC should embrace it. The rapid pace of digital innovation guarantees a highly competitive market with constant turnover and few enduring monopolies. Why would the EC force Microsoft to remove its browser when this is the user's gateway to competing products? According to the European web metrics firm XiTi, nearly 30 percent of customers have already switched to the competing Firefox browser, a product that is less than four years old.¹⁰⁷ Even though the Internet supplies users with almost unlimited possibilities for customizing their desktop, the EC seeks to override consumer choice and dictate which features are acceptable on European computers. In announcing its latest investigation, the EC signaled that it will not just seek to strip away Microsoft's Internet browser, but will target "a range of products" that "have been unlawfully tied to sales of Microsoft's dominant operating system."¹⁰⁸

Therefore, the European Union has become a venue for competitors seeking to dismantle successful products, leaving consumers with a limited choice between the degraded offerings of a regulated public utility and the inferior and overpriced offerings of failing firms. In the name of protecting competition, the EC now possesses the authority to direct and define the future of technological innovation worldwide.

IN THE NAME OF PROTECTING COMPETITION,
THE EC NOW POSSESSES THE AUTHORITY TO
DIRECT AND DEFINE THE FUTURE OF TECHNO-
LOGICAL INNOVATION WORLDWIDE.

AMERICAN CHIPS: The EU's Favorite Snack

“Just because [Intel has] this enormous marketing budget. Just because they have platforms everywhere in the world. It doesn't make it right. To take on smaller companies. It's just not right.”¹⁰⁹

—Jen-Hsun Huang, CEO, Nvidia

Kicking Intel When the Microchips Are Down

Emboldened by her victory over Microsoft, Neelie Kroes confidently proclaimed: “The shop is still open, I can assure you.”¹¹⁰ Any company in the world with a successful product and frustrated rivals could now be subject to extortion, bullying, and manipulation from the new global authority in antitrust enforcement. This fear was captured in September, 2007, by one industry lobbyist, who asked, “Will Neelie Kroes be leading a prison march of the world's most successful firms through her Brussels doors?”¹¹¹

Kroes answered this question in dramatic fashion when, less than five months later, she ordered a dawn raid on the German offices of Intel, the world's largest microchip manufacturer. In formal charges that had been filed against Intel in July 2007, the European Commission accused the company of pricing its products too low. Even though consumers benefit from quality products at bargain prices, the European antitrust model focuses primarily on the welfare of competitors. Therefore, the EC could order a dominant firm to inflict higher prices on consumers, or face fines equal to 10 percent of its global annual revenues.

While there is a similar law on the books in the United States, prohibiting the use of price discounts to harm competitors (referred to as “predatory pricing”), this statute has been thoroughly discredited and is rarely enforced. Passed in 1936, the Robinson-Patman Act was intended to protect family-owned businesses from competition during the Great Depression. The DOJ has not enforced this law in more than 40 years, and the FTC has issued only one complaint in the past 15 years. In 200 pri-

vate Robinson-Patman lawsuits filed in the past decade, the plaintiff has prevailed only twice. When Congress assembled its Antitrust Modernization Commission in 2002 to recommend changes to the nation's antitrust laws, this bipartisan panel of experts concluded unequivocally that "Congress should repeal the Robinson-Patman Act in its entirety."¹¹²

According to the AMC, "the economic reality is that price differences and price discrimination typically benefit, not harm, consumers." Because the Robinson-Patman Act "protects competitors, often at the expense of competition," it "is fundamentally inconsistent with the antitrust laws and harms consumer welfare."¹¹³ In the EU, however, protecting competitors takes precedence over consumer welfare.

Just as rivals conspired to invoke antitrust against Microsoft, so the EC's case against Intel hinges on the complaints of a competitor unable to achieve success fairly in the marketplace. Intel's sustained popularity has frustrated Advanced Micro Devices (AMD), leading the company's founder and then-CEO, Jerry Sanders, to label its dominant rival "a fascist organization,"¹¹⁴ an "800-pound gorilla,"¹¹⁵ and a "bully-boy."¹¹⁶ For more than 15 years, AMD has sought to bolster its market share unfairly through lobbying and litigation.

In the United States, regulators have consistently rejected AMD's assertion that low prices hurt consumers. After spending two years investigating these complaints, and examining more than 250,000 internal Intel documents, the Federal Trade Commission concluded in 1993 that "no further action is warranted by the commission."¹¹⁷ Because antitrust laws provide unlimited bites at the apple, AMD sought a more favorable verdict through private antitrust litigation. In private antitrust, plaintiffs frequently use exorbitant damage claims to extort settlements from dominant firms. For instance, AMD demanded up to \$6 billion¹¹⁸ in its 1991 lawsuit, a sum equal to five times its yearly revenues.¹¹⁹ By the time the two companies settled nearly four years later, AMD had diverted nearly \$100 million away from research activities to fund its litigation. Seymour Merrin, founder of the Computer Technology Industry Association (CTIA), remarked bluntly that putting this money back into innovation "will make chips cheaper because consumers won't have to pay for all the stupid lawyers."¹²⁰

After reaching this settlement with Intel, AMD's Jerry Sanders declared "global peace"¹²¹ and vowed that, in the future, "we're not going to rely on the U.S. government to beat them; we're going to beat them with innovation."¹²² This commitment would be short-lived. Between 1997 and 2000, new complaints by AMD fueled another antitrust investigation by the FTC.

Just as in 1993, the FTC again concluded that "no further action is warranted by the commission."¹²³ After reviewing the case against Intel, one commissioner found no "reason to believe that Intel's actions . . . adversely affected competition and innovation" or "threatened to harm the consuming public."¹²⁴ After two investigations examining the same evidence and reaching the same conclusion,

AMD hopes the third time will be the charm. Believing that a new administration might ultimately look more favorably on its complaints, AMD persuaded the FTC to launch a new formal investigation in June 2008.

AMD has also recycled its antitrust complaints into a new private lawsuit. In addition to damages, the company seeks an injunction forbidding Intel from offering rebates and discounts. If AMD prevails, the result would be to harm consumers through mandated higher prices. As of May 2008, AMD's lawyers had reviewed more than 200 million documents.¹²⁵ If placed end to end, these products of litigation would reach from Washington, D.C., to Brussels more than 10 times. And as it happens, Brussels is exactly where the company decided to export its complaints in search of a friendlier venue.

At first, the European Commission agreed with its American counterpart that Intel's low prices benefited consumers. In 2002, the EC terminated its investigation after it had "carefully examined the complaints it received concerning Intel" and "concluded that they are not founded."¹²⁶ However, AMD refused to withdraw its complaint, and in 2004 the EC suddenly began investigating these same charges anew. What happened in the intervening two years to warrant this change of heart? Because foreign governments frequently employ antitrust to protect domestic firms from competition, AMD dramatically altered its business strategy to render itself worthy of EU protection.

FOREIGN GOVERNMENTS FREQUENTLY EMPLOY
ANTITRUST TO PROTECT DOMESTIC FIRMS
FROM COMPETITION.

In 2003, the company abandoned plans to build a new factory in Singapore, and suddenly relocated the \$2.4-billion project to Dresden, Germany. AMD's CFO Bob Rivet boasted to shareholders that, in return for creating thousands of jobs in the EU, the company would receive "substantial government-backed financial incentives."¹²⁷ As part of this *quid pro quo*, the company received direct cash subsidies (\$676 million in 2004 and another \$361 million in 2007), as well as what Rivet described as "some help from our friends."¹²⁸ By fining dominant market leaders and using the money to subsidize failing firms, the EU provides its "friends" with implicit government protection from competition.

By 2008, AMD desperately needed such help. The company's stock had plummeted 83 percent in less than two years, and its revenues had dropped \$4 billion in one year. In the face of these losses, executives planned to cut 10 percent of AMD's global work force.¹²⁹ In an attempt to blame these misfortunes on Intel, one top official claimed that low prices for Intel's customers had created an "unjust and illegal monopoly tax" for AMD's customers.¹³⁰ In reality, however, computer manufacturers had not conspired with Intel and boycotted AMD's products, but had actually bolstered AMD's business in order to keep a viable competitor in the market. An article in *Wired* in December, 2007, explained this phenomenon: "almost every major computer manufacturer now offers both Intel- and AMD-

equipped computers. In the end, those PC manufacturers all have a vested interest in keeping AMD around . . . they also tend to enjoy playing one chipmaker off of the other to get favorable pricing.”¹³¹

Therefore, what AMD lacked was not the opportunity to compete, but the ability to market a competitive product. The company’s failures stemmed from technical glitches and business blunders for which it has only itself to blame. In 2007, its newest line of chips was delayed for more than eight months because of design flaws, bugs, and production problems. Company officials were also forced to admit that they had overpaid by \$1.6 billion in acquiring the graphics chip maker ATI. Instead of blaming Intel for AMD’s misfortunes, former CEO Hector Ruiz confided to his shareholders that “we blew it, and we’re humbled by it.”¹³² But that did not stop AMD from pursuing its case before the EC.

When Neelie Kroes filed formal charges against Intel in 2007, AMD hoped to benefit from the EU’s philosophy of forcibly leveling the playing field for inferior products. According to Kroes, “rebates and discounts cannot be used by a dominant company as part of a strategy to exclude actual and potential competitors.”¹³³ In other words, companies cannot offer consumers a good deal unless their competitors can reasonably match it.

Even though Kroes argues that “there is not that much difference”¹³⁴ between antitrust enforcement in the European Union and the United States, this prohibition against low prices directly contradicts the rationale behind antitrust law: protecting consumer welfare. In the United States, the Supreme Court has affirmed that “cutting prices in order to increase business often is the very essence of competition,”¹³⁵ and a former DOJ antitrust official in charge of international enforcement proclaimed that “there is no rational reason to deny consumers the benefits of lower prices.”¹³⁶

By punishing companies for lowering their prices, the European Commission deprives consumers of affordable access to cutting-edge technologies. The EU’s case against Intel was launched only five days after the company slashed prices by 50 percent on its most advanced processors. Instead of welcoming these low prices on behalf of European consumers, the commission is currently threatening to fine Intel over \$2 billion, nearly 40 percent of the EC’s annual budget. The EC uses the proceeds of these exorbitant fines to fund the continued prosecution of leading American firms and subsidize failing competitors.

BY PUNISHING COMPANIES FOR LOWERING THEIR PRICES, THE EUROPEAN COMMISSION DEPRIVES CONSUMERS OF AFFORDABLE ACCESS TO CUTTING-EDGE TECHNOLOGIES.

In addition to seeking protection from the European Commission, AMD is also exploiting the protectionist impulses of individual states’ attorneys general. Under U.S. antitrust law, any state can redundantly enforce federal statutes on behalf of its citizens. Federal regulators, as we have seen,

found no merit in AMD's accusations, but the company wields considerably more political leverage in New York State than in Washington, D.C. The state recently offered \$1.3 billion in enticements for the company to locate a planned \$3.2-billion factory outside of Albany. Although a preliminary agreement is in place, AMD has maximized its influence over state officials by keeping the factory in limbo until July 2009.

Under these questionable circumstances, in January 2008 Attorney General Andrew Cuomo asserted the broad power of his office to launch his own antitrust investigation of Intel. Because no technology company can afford to market different products for each state, Cuomo can prohibit computer manufacturers nationwide from accepting Intel's rebates, resulting in higher prices for consumers. Perceiving that Cuomo was acting only in his own state's narrow interests, other state attorneys general declined to join his investigation. Between 1980 and 2006, less than 5 percent of all state antitrust cases were brought by a single attorney general without the cooperation of his colleagues.¹³⁷

Notably, although both major participants in this \$30-billion market are based in California, Cuomo failed to gain the support of California Attorney General Jerry Brown. Brown, a former California governor, once railed against "immoral corporations that operate by an undemocratic code, with no soul and no conscience."¹³⁸ Even so, having examined the merits of Cuomo's case, he concluded that "I'm not barking at every truck that comes down the street."¹³⁹

The AMD suits are a key example of how antitrust enables savvy companies to foist inferior and over-priced products on consumers by government fiat. While competition can create more choices and lower prices, the mere presence of competition does not guarantee them. Instead, companies innovate when they are driven to outcompete, not merely compete. If struggling firms exploit antitrust as a sanctuary from competition, failing products persist and hold back the rise of true innovations.

COMPANIES INNOVATE WHEN THEY ARE
DRIVEN TO OUTCOMPETE.

APPLE-PICKING TIME

*“I bought an iPod and can only shop at one store. What is this? The Soviet Union?”¹⁴⁰
—Reaction predicted by Rob Glaser, CEO, RealNetworks*

*Apple CEO Steve Jobs “makes for a good piñata because he’s taken a position against interoperability.”¹⁴¹
—Rob Glaser*

For most of its 30-year history, Apple appeared an unlikely target for antitrust scrutiny. Its computers and operating system appealed strongly to a niche market of loyal customers willing to pay more for better design. Even at its peak, the company controlled only 16 percent of the PC market.¹⁴² The company’s iconic CEO, Steve Jobs, frequently defended his company’s low market share by comparing his products with high-quality luxury items: “Apple’s market share is bigger than BMW’s or Mercedes’ or Porsche’s in the automotive market. What’s wrong with being BMW or Mercedes?”¹⁴³ In 2001, however, Apple broke out of this mold and released a product that revolutionized how consumers worldwide listen to music.

The iPod music player achieved rapid and broad popularity, giving customers the freedom to store their entire music library on a single pocket-sized device. The significance of this technology for society was so apparent that Apple’s chief designer, Jonathan Ive (a British subject), received a CBE, the third highest royal honor, from Queen Elizabeth.¹⁴⁴ When the company unveiled its iTunes music service in 2003 to provide iPod users with a vast selection of affordable digital media, the service was named “Invention of the Year” by *Time* magazine.¹⁴⁵

Apple’s innovations achieved remarkable success in the marketplace. A 2007 article in the *San Jose Mercury News* noted that “Apple’s stock is up nearly 1,200 percent since Jobs took over in 1997 and its revenue and profits are at record heights. The company’s PC sales are surging, it dominates the world

of digital music, and it seems poised to reshape the market for home video entertainment.”¹⁴⁶ In less than five years, iTunes sold four billion songs and captured 70 percent of the digital music market. Over the next five years, Apple is on track to capture nearly 30 percent of the entire music market.¹⁴⁷ Apple’s renaissance embodies how a thriving technology sector can transform society and boost the economy.

The rapid rise in popularity of iTunes and the iPod product line also demonstrates the unpredictable nature of technology markets. Apple’s dominant position in digital media, in turn, could quickly dissipate in the face of new technologies with superior features. After their experience with Microsoft, U.S. regulators are wary of interfering with constantly evolving technological innovations. In the global antitrust game, however, foreign jurisdictions freely attack successful American firms to further their own national interests.

Thomas Barnett, the Justice Department’s top anti-trust official, recently expressed frustration that foreign bureaucrats could derail the digital media revolution. As Barnett put it, “you might think that by creating a product to which consumers have flocked of their own free will and by mitigating the piracy problem, Apple would be cheered for pioneering greater access to music. But you would be wrong.” Unfortunately, Barnett continues, “Apple is now under assault in a number of jurisdictions on the grounds that iTunes is too dominant and does not ‘interoperate’ with devices other than iPods.”¹⁴⁸ In the aftermath of the Microsoft case, many competitors believe that as long as a product has achieved dominant market status, they have the right to incorporate it into their own products as if they had designed it themselves—that is what “interoperability” actually means. If these rivals still cannot compete, governments could force a company to handicap its own product, making it less desirable to consumers.

MANY COMPETITORS BELIEVE THAT AS LONG AS A PRODUCT HAS ACHIEVED DOMINANT MARKET STATUS, THEY HAVE THE RIGHT TO INCORPORATE IT INTO THEIR OWN PRODUCTS AS IF THEY HAD DESIGNED IT THEMSELVES.

According to this established precedent, regulators could require iPods to interface with all music services with the same ease with which they interface with iTunes, or require iTunes to interface similarly with all digital devices. This would remove the need for other device makers to develop superior music services or for other service providers to design superior devices. In the United States, the Supreme Court has recognized that such mandated sharing directly contradicts “the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.”¹⁴⁹

In Europe, however, a dominant company’s products can be expropriated by the state and converted to public property if that would aid the survival of competitors. One of Apple’s rivals, RealNetworks, has substantial experience in manipulating antitrust authorities. As a member of the anti-Microsoft

conspiracy, RealNetworks helped the EC strip Microsoft's media player from Windows to make it easier for RealNetworks' own product to compete. By treating Windows as a public utility, the EC assumed authority to micromanage the technological offerings of American companies. As a struggling competitor, RealNetworks CEO Rob Glaser praised the EU for designing a system "resulting in the greater likelihood of good decisions happening consistently."¹⁵⁰

In 2005, RealNetworks and Microsoft reached a broad settlement of all antitrust disputes, and both companies turned their attention to Apple. Before this settlement, Glaser denied having competition issues with Apple, telling the *New York Times* that Steve Jobs' "model works for him, and ours works for us. We don't compete head-on."¹⁵¹ Only two months after concluding his antitrust battles with Microsoft, however, Glaser complained that "there's no reason we should penalize Apple customers for Steve's pigheadedness."¹⁵²

Even though iTunes is only five years old, and consumers can choose from a variety of interoperable alternatives (including Amazon.com's Amazon MP3 store¹⁵³), Norwegian regulators in 2007 declared iTunes "illegal," and formal investigations were opened in Finland, France, Sweden, Denmark, and Germany.¹⁵⁴ While the EC has not yet filed charges to enforce mandatory interoperability, recent comments suggest that action may be imminent. According to Consumer Protection Commissioner Meglena Kuneva, "Something has to change. Do you think it's fine that a CD plays in all CD players but that an iTunes song only plays in an iPod? I don't."¹⁵⁵

While the EC has yet to dictate how Apple designs its products, it recently asserted its authority to control prices. By subverting the market and limiting incentives for success, these price controls threaten to restrict the availability of cutting-edge technologies to European consumers. Because record labels charge Apple different prices in different countries for the right to distribute their music, the company adjusted its prices to suit these discrepancies. Even though regulators made no attempt to normalize Apple's supply costs, Neelie Kroes insisted on "a truly single market for music downloads."¹⁵⁶ In early 2008, Apple acquiesced to the EC's demands and agreed to charge identical prices in every individual market across Europe. Rather than face a boundless and endless investigation, Apple agreed to handicap its business model and limit its future incentives to innovate.

By forcing the most creative companies to play by different rules from their competitors, antitrust discourages the free and active experimentation behind industry-changing inventions. As a result, governments, rather than consumers, drive the development of new products. In the market for digital media, consumers seek lower prices and more flexibility to download the entertainment of their choice. Yet,

BY FORCING THE MOST CREATIVE COMPANIES TO PLAY BY DIFFERENT RULES FROM THEIR COMPETITORS, ANTITRUST DISCOURAGES THE FREE AND ACTIVE EXPERIMENTATION BEHIND INDUSTRY-CHANGING INVENTIONS.

when major record labels attempted in October, 2007, to satisfy these demands with a new service offering unlimited, free downloads, antitrust regulators sought to scuttle the concept.¹⁵⁷

Rather than focus on the needs of consumers, regulators often heed the complaints of self-interested players who fear competition from popular new services. One competing digital music provider complained that any unlimited download service offered by record labels would be “a cartel in violation of competition laws.” Therefore, this rival continues, “they leave us no choice but to protect consumers and ourselves from these grievous practices.”¹⁵⁸ Such complaints continue to block the services and features that customers demand, even though the DOJ has already admitted that despite expending “substantial time and resources,” it has “uncovered no evidence that the major record labels’ joint ventures have harmed competition or consumers of digital music.”¹⁵⁹

Facing a vast unmet demand, Apple recently considered developing its own unlimited download service. Only hours after rumors broke about this plan in March 2008, David Pakman, the CEO of eMusic (an iTunes competitor) declared, “That’s classic Sherman Antitrust Act behavior.” Making clear that antitrust should apply only to Apple, and not to any similar service that eMusic might offer, Pakman claimed that “because they’re a monopolist, they’re going to be held to a different standard.”¹⁶⁰ Under this “different standard,” companies reach a “success cap,” at which point they are forbidden to engage in activities that might lead to additional future success.

The success cap punishes innovators who drive technological change, and rewards followers, failures, and copycats. These also-rans enlist the help of “consumer advocates,” who readily seize the myth of unstoppable dominance. According to the New America Foundation’s Reihan Salam, if the government allows iTunes to become “a musical monolith,” then “the iPod will crush all other music-playing devices for 1,000 years by building an overwhelmingly dominant music retail platform.”¹⁶¹ Even though iTunes is only five years old, proponents of the success cap assume that 995 years must pass before a similarly innovative product could undermine Apple’s dominance.

The iPod/iTunes revolution in digital media has radically transformed society. As new technologies develop in rapid and unpredictable ways, however, the next revolution may be just around the bend. These future innovators and investors are watching closely how regulators treat Apple. If governments employ antitrust to cap success and seize property, companies will adjust their strategies to follow and copy, not lead and transform.

IF GOVERNMENTS EMPLOY ANTITRUST TO CAP SUCCESS AND SEIZE PROPERTY, COMPANIES WILL ADJUST THEIR STRATEGIES TO FOLLOW AND COPY, NOT LEAD AND TRANSFORM.

QUALCOMM: EC Phone Home?

*“It’s the EU against Qualcomm . . . They are kind of like the whipping boy now; they are the new Microsoft.”*¹⁶²
—Ed Zander, CEO, Motorola

European Union Attempts to Steal American Mobile Phone Technology

In the three previous cases, governments and rival firms employed antitrust to handicap or sabotage successful companies and prop up unpopular technologies. When a revolutionary new technology develops so suddenly that it renders all competing products obsolete, however, regulators are left with nothing to prop up. In these situations, antitrust can enable the state to steal inventions and hand them over to competitors. Even though this may provide short-term consumer benefits, using antitrust to weaken intellectual property (IP) rights can chill future innovations. If companies cannot profit from investing in big ideas, the incentives to research, develop, and create will rapidly evaporate.

IF COMPANIES CANNOT PROFIT FROM
INVESTING IN BIG IDEAS, THE INCENTIVES
TO RESEARCH, DEVELOP, AND CREATE
WILL RAPIDLY EVAPORATE.

In the mobile phone industry, no innovator has had a more profound, sudden, and revolutionary role than Irwin Jacobs, a former engineering professor at the University of California at San Diego. Qualcomm, the company Professor Jacobs founded in his den in 1985, today holds more than 6,000 patents and controls the technology running 20 percent of the world’s cell phones. This enormous success all started with a single idea.

Jacobs turned this idea into a radical and superior technique for transmitting information on mobile networks known as “code division multiple access” (CDMA). Within 10 years, CDMA had fundamentally transformed wireless telecommunications, earning Jacobs the 1994 National Medal of Technology. Upon bestowing the medal, Vice President Al Gore counted Jacobs among his “true

national heroes” for contributing “so much to our nation’s prosperity, health, security, and overall quality of life.”¹⁶³

For companies deeply invested in competing technologies, the introduction of CDMA posed a life-or-death threat to entrenched business models. Hoping to stave off obsolescence, these rivals initially attempted to prevent CDMA from reaching the market. In what became known as “the Holy Wars of wireless,”¹⁶⁴ rivals ridiculed Qualcomm’s technology as a myth and a hoax. A representative of the Swedish telecommunications firm Ericsson proclaimed in 1990 that “they are looking at a rainbow.”¹⁶⁵ Stanford University electrical engineering professor Don Cox (whose previous employer, AT&T, had adopted a competing technology) called CDMA “a religion.” According to Cox, “You don’t get facts, you get ‘I believe.’”¹⁶⁶

By 2000, however, few questioned the superiority of Qualcomm’s underlying technology. In that year, the International Telecommunications Union, a UN-sponsored standards body, concluded that all the standard technologies for next-generation mobile devices should be based on CDMA. As one industry analyst explained, “Qualcomm has largely won the war. Every major vendor of equipment and devices . . . has to use CDMA. To live and breathe, they have to use CDMA. And to do that, they have to license from Qualcomm.”¹⁶⁷ Unlike Microsoft’s operating system, Intel’s microchips, and Apple’s iPods, the fruits of Qualcomm’s labors are not physical items, but the ideas that drive an entire generation of products.

For a company built on creative ideas, intellectual property can be far more important than physical property. More than 70 percent of Qualcomm’s profits are generated by licenses and royalties on the company’s patents. In the United States, regulators are highly skeptical of attempts by competitors to use antitrust as an end-run around patent protections. Therefore, intellectual property cannot be used to establish dominant market power, and the government does not set royalties or force successful firms to share IP with rivals. Though the FTC did recently claim this authority in a case against Rambus, the world’s leading developer of high-speed memory chip technology, an appeals court unambiguously dismissed the FTC’s decision in April, 2008, as a “murky” and “aggressive interpretation of rather weak evidence.”¹⁶⁸ At the DOJ, antitrust division head R. Hewitt Pate explained that “bringing a complaint to the Antitrust Division about ‘excessive’ royalties, without more, is a losing strategy. Antitrust enforcers are not in the business of price control. We protect a competitive process, not a particular result, and particularly not a specific price.”¹⁶⁹

FOR A COMPANY BUILT ON CREATIVE IDEAS,
INTELLECTUAL PROPERTY CAN BE FAR MORE
IMPORTANT THAN PHYSICAL PROPERTY.

In the EU, however, regulators can expropriate a successful firm’s property, whether tangible or intellectual, if it would aid less successful competitors. According to Neelie Kroes, a company cannot

“stifle innovation by charging other companies prohibitive royalty rates.”¹⁷⁰ Because European anti-trust authorities can raid the patents of American firms, Qualcomm’s competitors flocked to this favorable venue in search of free or deeply discounted access to valuable intellectual property.

Just as anti-Microsoft forces conspired under the code name “Project Sherman,” anti-Qualcomm conspirators created the top-secret “Project Stockholm.”¹⁷¹ Stockholm refers to the headquarters of Ericsson, which, along with Broadcom, NEC, Nokia, Panasonic, and Texas Instruments, filed complaints with EU regulators in 2005. These rivals alleged that Qualcomm’s licensing fees and practices restricted competition, and asked the European Commission to set more favorable prices. Jumping at the opportunity to collect potentially more than \$700 million in fines, the EU embraced these rivals’ complaints and opened an official investigation in October 2007. To streamline the process of extorting successful American firms, Kroes has fast-tracked the investigation and could rule by the end of 2008.

By weakening intellectual property protections in the name of competition, the EC steals from those who take risks in order to benefit those who don’t.

THE EC STEALS FROM THOSE WHO TAKE RISKS
IN ORDER TO BENEFIT THOSE WHO DON’T.

If regulators punish innovators for profiting from their ideas, the incentive to take these risks could disappear. In 2007, Qualcomm spent \$200 million in legal fees to fend off the attacks on its intellectual property.¹⁷² As a result, a company once described by *Newsweek* as “more a telecom think tank than a manufacturer”¹⁷³ has, in the eyes of current CEO Paul Jacobs (son of Irwin Jacobs), “become very much of a law firm.”¹⁷⁴

Not only do competitors hope to win bargain prices on Qualcomm’s current technologies, but they also seek to forestall development and adoption of future innovative technologies. By deluging the company with legal distractions, these rivals gain unfair advantages for competing technologies. As the industry settles on critical standards for the next generation of wireless technologies, upcoming decisions will define the quality of mobile communications for years to come. If successful, these attacks on Qualcomm’s business model could deprive consumers of superior products and restrain the growth of mobile Internet services.

In the United States, the Project Stockholm conspirators failed to convince government regulators that antitrust should be invoked to weaken patent protections. In 2005, Broadcom filed a private anti-trust lawsuit, and even hired David Boies, the attorney who successfully led the DOJ’s prosecution of Microsoft. After preliminary review of the facts, U.S. District Court Judge Mary Cooper dismissed the entire case, concluding that “the alleged conduct does not support claims for monopolization or attempted monopolization.”¹⁷⁵ While an appeals court ruled in September, 2007, that the case could proceed, it labeled Broadcom’s antitrust claims “simply insufficient,” “highly speculative,” and “extremely remote.”¹⁷⁶

“International” Antitrust on American Soil

Having failed with traditional antitrust tactics, Broadcom uncovered an obscure loophole in U.S. law, opening an entirely new avenue for rivals to bully and extort successful firms. In 1916, Congress created the U.S. International Trade Commission (USITC or ITC, originally called the Tariff Commission) to advise the government on trade policy. As a self-described “quasi-judicial federal agency,”¹⁷⁷ the USITC has no policy-making authority, and is made up of six political appointees. Congress did grant the USITC one critical enforcement authority hidden within the Smoot-Hawley Tariff Act of 1930, a law that the Council of Economic Advisers declared in 1988 was “probably one of the most damaging pieces of legislation ever signed in the United States.”¹⁷⁸

To deter foreign firms from infringing on American patents, the Smoot-Hawley Act empowers the USITC to block importation of products built on stolen intellectual property. Because the law does not actually specify that the infringing firm must be foreign, however, it can technically be invoked to settle disputes between two American firms. Even though American companies have ample avenues for challenging patent infringement in U.S. courts, the USITC provides a parallel, and much more plaintiff-friendly, alternative. As long as an American firm assembles its products in factories abroad, the USITC can unilaterally ban it from marketing those products in the United States.

Unlike the U.S. court system, the USITC is not bound by conventional laws, rules, and guidelines for adjudicating patent cases. Instead of a jury, all cases are heard before an administrative law judge, who has little time to consider the complexity of a technology patent. According to Richard Cunningham, a senior international trade partner at Steptoe & Johnson, “the proceeding can be absolutely hell on wheels. It takes a nice leisurely four-year patent litigation and compresses it into about six months.”¹⁷⁹ As opposed to conventional proceedings in U.S. courts, the USITC is under no obligation to determine whether the patent is actually valid. Companies can present any obvious or second-hand “discovery,” and, by law, “the Commission shall presume the facts alleged in the complaint to be true.”¹⁸⁰

The ITC can function as an additional missile in the growing antitrust arsenal. Because a ban on imports would cripple most technology firms, the ITC allows competitors to extort unreasonable remedies from leading innovators. In its vendetta against Qualcomm, Broadcom filed an infringement complaint with the ITC in May, 2005, (even though both companies are based in California), two months before launching its antitrust lawsuit in the United States, and five months before filing complaints in the European Union. On the basis of a relatively simple and nonessential patent held by Broadcom, the ITC in July 2007 banned import of all new mobile phones and devices containing Qualcomm’s most advanced chips.

THE ITC ALLOWS COMPETITORS TO
EXTORT UNREASONABLE REMEDIES
FROM LEADING INNOVATORS.

Because Qualcomm supplies 98 percent of the chips used by Verizon and Sprint Nextel and 30 percent of the chips used by AT&T, the ban directly threatened to stunt all future growth in the U.S. mobile industry. The economic cost of the ruling was projected to range between \$4.3 and \$21.1 billion, according to a Brattle Group study.¹⁸¹ Regulators at the FCC expressed outrage that another federal agency would recklessly force “higher prices, lower quality, and less innovation” on American consumers.¹⁸² In Congress, a bipartisan chorus (including the chairman of the House Ways and Means Committee and the ranking member of the House Energy and Commerce Committee) complained that the ITC “will stifle the efforts of wireless carriers to deliver cutting-edge technologies to American consumers.”¹⁸³

Broadcom successfully used the ITC’s intellectual property authority as a pretext for extorting antitrust remedies. Ironically, Qualcomm’s rivals sought to leverage the ruling to weaken intellectual property rights and steal more favorable access to the creative ideas of dominant competitors. According to Broadcom CEO Scott McGregor, the battle had little to do with protecting his company’s patents. Instead, “the real core issue is that [Qualcomm] is trying to hold onto an antiquated business model and doesn’t want to let go.”¹⁸⁴ This “antiquated business model” is the royalty-based system that allows true innovators to profit from their inventions. Without this reward for taking risks, companies can no longer thrive on ideas alone. As explained by Qualcomm’s general counsel, Lou Lupin, “Broadcom is trying to use this proceeding to destroy our business. The ITC has unwittingly aided and abetted them.”¹⁸⁵

Though Qualcomm won a temporary stay in September, 2007, to appeal the import ban, the ITC has emerged as a powerful new domestic antitrust enforcement agency. Without any explicit mandate from Congress, the “international” trade commission enables struggling American firms to attack their more successful American counterparts. When combined with the EU’s growing willingness to seize and redistribute intellectual property in the name of competition, the ITC’s power grab threatens to deter entrepreneurs worldwide from marketing their most creative ideas.

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CONCLUSION: Slay the Global Antitrust Behemoth

American policy makers should fear the antitrust beast their predecessors unleashed nearly 120 years ago. What began as a cheap political move to shield campaign donors with high tariffs has morphed into a perverse international game. Today, every aspiring entrepreneur must weigh the potential benefits of success against the daunting threats of an antitrust monster that feeds on success. This monster's power continues to grow out of control: today's innovators face debilitating punishment from the Federal Trade Commission, the Department of Justice, the Federal Communications Commission, the attorneys general of all 50 states, the District of Columbia, armies of trial lawyers specializing in private antitrust litigation, the governments of 113 countries (and the number is growing), and the International Trade Commission.

Technology companies must divert critical resources from research and creation to appease the arbitrary whims of self-serving bureaucrats. Under the guise of "protecting consumers," antitrust laws consistently benefit only regulators, state-owned and state-subsidized firms, and the inferior products of struggling competitors. By allowing government to manipulate commerce, antitrust laws shield and protect failing companies from pro-consumer competitive market forces.

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The antitrust system is fundamentally anti-technology, anti-innovation, and anti-consumer. By weakening the flexibility to adapt and create, this corrupt, erratic, and tyrannical framework threatens not only America's competitiveness in the global digital economy, but the very existence of this economy itself.

As countries around the world assume authority to extort and bully America's most successful companies, unfriendly governments will increasingly see antitrust as a tool for bolstering their nation's influence on the global political stage. The time has come for a moratorium on international anti-trust hostilities.

With low overhead and rapid information flow, the digital revolution has spawned the most flexible and unpredictable innovation ecosystem in the history of mankind. Marked by dramatic and frequent cycles of creative destruction, the technology sector naturally resists monopolies. Even the most seemingly invincible corporate empire could be only a few mouse clicks away from complete implosion. The interactive and collaborative nature of the Internet only hastens these dramatic market changes. Every customer gained by a creative online startup wins over hundreds or thousands of friends within that customer's social network. When regulators attempt to manipulate what they can't predict, they stop potentially transformative technologies from seeing the light of day.

Because of the complexity of new technologies, even well-intentioned regulators are ripe for manipulation. Their ignorance, coupled with the expanding scope of antitrust law, has fueled the meteoric growth of a high-tech lobbying industry. Whereas antitrust lobbyists once protected dominant firms from unwarranted government scrutiny, lobbyists today argue aggressively on behalf of small firms seeking to cripple a successful rival. Even startups now rely on lobbying over innovation to sabotage competitors and gain a foothold in the market. In essence, these laws encourage anticompetitive behavior while supposedly fostering competitive behavior.

In the European Union, bureaucrats routinely value the needs of competitors over the interests of consumers. The EC increasingly exerts its authority to blackmail and micromanage American firms, establishing its position as the world's unquestioned antitrust enforcer. As demonstrated by the developing cases against Microsoft, Intel, Apple, and Qualcomm, the European Union now assumes the right to disable products, force higher prices on consumers, raid intellectual property, and seize innovations for the good of competitors. American policy makers must act now to end the global antitrust game and rein in a corrupt, out-of-control system.

AMERICAN POLICY MAKERS MUST ACT NOW TO
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RECOMMENDATIONS

Though America invented antitrust, today the problem is international. Nondemocratic regimes such as China's could soon wield antitrust as a global political bargaining chip. No proposed solution can end the antitrust game completely; however, policy makers can act to dramatically lessen its impact on rapidly evolving technologies. To protect the future of technological innovation, lawmakers should:

- Pass legislation requiring that any foreign antitrust action against a company based in the United States must receive the cooperation, or at least the permission, of American authorities. The law should leverage America's influence in the global economy by threatening sanctions sufficient to deter renegade antitrust actions. Because of substantial cooperation between U.S. antitrust authorities and their counterparts abroad, this legislation would likely deter only the most egregious abuses. Ultimately, protectionist antitrust policies must also be viewed as an enforceable violation of negotiated trade agreements.
- Empower the U.S. trade representative to bring cases in the World Trade Organization against countries that unfairly use antitrust to protect domestic firms and interests.
- Repeal the Hart-Scott-Rodino Act in its entirety.
 - o Alternatively, require that state antitrust claims can be brought only by the attorney general with jurisdiction over the target company's base of operations.
 - o Stop funding the DOJ and FTC with fees collected from target companies.

- Affirm that mergers and acquisitions are never anticompetitive, but instead represent essential responses to changing market conditions. The government should have no pre- or post-merger authority to challenge these business decisions.
- Recognize the overwhelming legal and scholarly consensus that competitive pricing benefits consumers, and repeal the Robinson-Patman Act in its entirety.
- Close the loophole in the Smoot-Hawley Tariff Act granting the USITC jurisdiction over disputes between American firms.
- Prevent the manipulation of rapidly evolving industries by immunizing dominant firms from all forms of antitrust scrutiny until enduring dominance is demonstrated (10 to 20 years).

The continued global expansion of vague, inconsistent, and protectionist antitrust policies threatens to deter entrepreneurs from investing in transformative technologies. Just as American policy makers created the antitrust catastrophe, American legislators should lead the charge against this failed experiment in fostering competition. True competition results when consumers, not governments, decide which products and services thrive in a dynamic marketplace.

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