

Exploring the Source of Transatlantic Antitrust

Divergence

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Abstract

This paper seeks to explore the sources of substantive divergence between the antitrust regimes of the U.S. and EC and to present a framework upon which harmonization could potentially be achieved. While the rise of the Chicago School and post-Chicago theory have merged to ensure a central role for economics in dictating antitrust enforcement in the United States, no such clear standard has emerged in Europe. The consequences for firms operating on a transatlantic basis are potentially severe, as they have to formulate different business strategies depending on which jurisdiction they operate in. An assessment of EC law demonstrates an interesting amalgam of conflicting jurisprudential bases, including the overriding goal of achieving single market integration, the pervasive, though subtle, presence of ordoliberal thought and a qualified desire to protect small competitors from more efficient rivals. It will be argued that the transatlantic schism currently witnessed is not inevitable and that the unique roles played by competition policy in the EC do not prohibit the employment of price theoretic principles.

This paper will seek to articulate a basis for the asymmetry in treatment given certain business practices by the U.S. and EC. Doing so will enable businesses to more readily understand the construction given corporate behavior by European authorities and to adopt their strategies accordingly. Moreover, a framework will be advanced that is facilitative of modern economic theory and which would, if universally employed, bring Europe not only to harmonization with the United States but to the end toward which it is already gravitating.

Exploring the Source of Transatlantic Antitrust Divergence

- *Introduction*

Competition law, as a distinct discipline, has been subject to a fascinating and turbulent history.¹ Inextricably linked to such fields as economics, politics and sociology, vigorous debate has ensued as to the proper manner in which to employ the potent provisions antitrust has at its disposal.² Such divisive discourse has ultimately failed to produce a clear standard enjoying the support of a plain majority of the world's commentators. The result has been a plethora of arguably flawed case law, flowing from a ubiquitous judicial failure to derive and articulate a consistent and sound body of principles from the internally inconsistent, and often diametrically opposed, academic literature.³ Much of the ensuing jurisprudence can be characterized by the adoption of economically illiterate principles, due to courts' intuition in a field where the economic effect of various business practices may be strongly counter-intuitive.⁴

¹ See generally RUDOLPH J.R. PERITZ, *COMPETITION POLICY IN AMERICA: HISTORY, RHETORIC, LAW*. (Oxford University Press 2000); DAVID J. GERBER, *LAW AND COMPETITION IN TWENTIETH CENTURY EUROPE: PROTECTING PROMETHEUS* (Oxford University Press 2001).

² Compare, e.g., RICHARD POSNER, *ANTITRUST LAW* (University of Chicago Press 2d ed. 2001), with Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979), with Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, COLUM. BUS. L. REV. 257 (2001).

³ See generally ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (2d ed. 1993) (discussing how the numerous political and socioeconomic ends toward which competition policy have been historically applied ultimately resulted in a confused body of law, full of inherently contradictory legal provisions.)

⁴ Tim Brennan, *Do advances in economic theory lead to advances in legal practice? The Legacy of U.S. v. Microsoft*, (2003) at <http://www.cato.org/pubs/regulation/regv26n4/v26n4-3.pdf> ("In the... "pre-Chicago," era, which lasted until the 1970s, economics took a back seat to impressionistic assessments of harm.")

Such unconsidered, and oftentimes intellectually erroneous, judicial interpretation provided the backdrop to the rise of the Chicago School in the 1980s – a body of thought dedicated to the employment of microeconomic theory as the tool by which to formulate competition rules for the sole benefit of consumers.⁵ Chicago has been met with opposing degrees of warmth on opposite sides of the Atlantic.⁶ The gulf has been further exacerbated by the rise of post-Chicago theory, calling for the combination of dynamic game theory with empiricism.⁷ Meanwhile, Europe remains concerned with numerous issues that do not trouble U.S. antitrust enforcers. Particularly prevalent amongst these is the overriding goal of furthering single market integration through the employment of competition law.⁸ Moreover, and as will be explored in detail below, a highly distinctive school of socio-economic thought, known as ordoliberalism, continues to pervade the law of the European Union.

As a result of the foregoing, the aspiration of achieving ubiquitous cooperation and uniformity through international antitrust harmonization faces a difficult, and what is perhaps a unique, challenge within the broader realm of international legal synchronization more generally.⁹ Strong divergence in opinion continues to arise as to how to best apply antitrust principles, or, perhaps more accurately, for whose benefit those principles ought to be applied.

⁵ Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. Pa. L. Rev. 925 (1979).

⁶ See, e.g., Thomas J. Horton & Dr. Stefan Schmitz, *A Tale of Two Continents: The Coming Clash of the Conflicting Economic Viewpoints in Europe and the United States*, at <http://www.orrick.com/fileupload/205.htm>.

⁷ See generally, Herbert Hovenkamp, *supra* note 2.

⁸ See, e.g., RICHARD WHISH, *COMPETITION LAW* (Butterworths 4th ed. 2003) at 18 – 20.

⁹ See, e.g., Pitofsky, *Competition Policy in a Global Economy – Today and Tomorrow*, (Nov. 4, 1998), at <http://www.ftc.gov/speeches/pitofsky/global.htm>.

In surveying the field as a whole, two particularly forceful insights have struck the author: (1) international synchronization in the context of such asymmetric theoretical underpinnings between and within jurisdictions poses a singular challenge, and (2) resolution of the inconsistencies underlying different jurisdictions' competition policies requires the identification, and ultimate acceptance, of a single foundational standard.

The focus of the following study shall, therefore, be on the extent and source of divergence between the two most important jurisdictions within the sphere of antitrust, namely the European Community and the United States. While there has been quite ostensible success to date in international antitrust cooperation between these two jurisdictions,¹⁰ it is clear that quite succinct distinctions exist and have been brought to the limelight in dramatic fashion in recent years. Foremost amongst these in terms of substantive divergence is the failed GE/Honeywell merger, which was vetoed in Europe, after having been approved in America.¹¹ It certainly seems that international

¹⁰ See, e.g., Pamela Jones Harbour, Remarks before NYSBA International Law and Practice Section, *Developments in Competition Law in the European Union and the United States: Harmony and Conflict*, (Oct. 21, 2005) (transcript available at <http://www.ftc.gov/speeches/harbour/051021competitionlaw.pdf>) ("From my perspective... there is far more harmony than conflict among US and EU competition enforcers. Furthermore, while we cannot rule out future conflicts, I believe that the trend is towards more convergence and harmony."); Margaret Bloom, *The U.S. and EU Move Towards Substantial Antitrust Convergence on Consumer Welfare Based Enforcement*, ANTITRUST, Vol. 19, No. 3 18, 22 (Summer 2005). See also Randolph W. Tritell, *International Antitrust Convergence: A Positive View*, (Summer 2005) at <http://www.ftc.gov/bc/international/docs/tritellpositiveview.pdf>; Remarks of Chairman Robert Pitofsky, *EU and U.S. Approaches to International Mergers - Views from the U.S. Federal Trade Commission*, before European Commission Merger Control 10th Anniversary Conference, The European Commission Directorate General for Competition, International Bar Association, Metropole Hotel, Brussels, Belgium, (14-15 Sept. 2000), at www.europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf

¹¹ Compare U.S. Dep't of Justice Press Release, Justice Department Requires Divestitures General Electric and Honeywell (May 2, 2001), at

harmonization has yet to achieve unqualified success and that the source of this shortcoming lies in the answer to one, misleadingly simple, question: to what ultimate end should competition law be applied?¹²

- *The Transatlantic Divide*

An economic approach to competition policy, which aims to promote consumer welfare by minimizing deadweight loss through the maximization of industrial output, today plays an increasingly important role in the function and application of competition law in the European Community.¹³ In particular, there is evidence that an economic approach to antitrust policy is becoming more widely accepted.¹⁴ Yet, in contrast to the United States, such an approach has yet to emerge as the primary and exclusively correct manner in which to apply competition law.¹⁵ Even a cursory examination of the case law reveals a strong desire on the part of European authorities to apply competition law with fairness in mind – a position abandoned in the U.S. following the Warren Court’s era.¹⁶

Concordantly, European competition policy is best described, at present, as constituting an amalgam of various philosophic, political and economic policies and ideals. The result

http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm, with *General Electric*/COMP/M.2220, EC Decision of July 3, 2001, at

http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf.

¹² Charles A. James, *International Antitrust in the 21st Century: Cooperation and Convergence*, (Oct. 17, 2001), at <http://www.usdoj.gov/atr/public/speeches/9330.pdf>.

¹³ See, e.g., William J. Kolasky, *U.S. and EU competition policy: Cartels, Mergers, and Beyond*, at <http://www.usdoj.gov/atr/public/speeches/9848.pdf>.

¹⁴ See, e.g., RICHARD WHISH, *supra* note 8.

¹⁵ See, e.g., Alasdair Murray, deputy director of the Centre for European Reform, *Consumers and EU Competition Policy*, (Sept. 2005), at http://www.cer.org.uk/pdf/policybrief_consumers.pdf.

¹⁶ See, e.g., David J. Gerber, *Fairness in Competition Law: European and U.S. Experience*, at http://www.kyotogakuen.ac.jp/~o_ied/information/fairness_in_competition_law.pdf (Mar. 5, 2004).

is a body of law with somewhat conflicting objectives and principles which combine to create a significant challenge for international antitrust harmonization.

It is this distinction in philosophical outlook that has led to, what at times have been, quite major departures from the goal of achieving horizontal uniformity.¹⁷

Some of the criticism emanating from the United States has denounced the European Community for simply employing competition policy in a manner designed to benefit competitors, as opposed to consumers.¹⁸ “U.S. law protects consumers, not competitors” has been the cry.¹⁹ The axiomatic inference is that EC law has been, or is, applied without primary importance being placed on the consumer and that European competition law is, perhaps, biased in its application. Nepotism toward both “state champions” and small companies is a typical complaint.²⁰

Nevertheless, this paper will attempt to articulate a more perspicacious view to the effect that criticisms of the above nature may be fallacious, specious and ultimately obtuse insofar as they omit consideration of a most fundamental possibility – that perhaps EC

¹⁷ Charles A. James, *supra* note 12 (concluding that the EC/U.S. rift with respect to GE/Honeywell can only be explained by a diametrically opposed fundamental view as to the role of competition law, rather than by any lack of cooperation.)

¹⁸ See Department of Justice Press Release, Statement by Assistant Attorney General Charles A. James on the EU’s Decision Regarding the GE/Honeywell Acquisition (July 3, 2001), at http://www.usdoj.gov/atr/public/press_releases/2001/8510.htm.

¹⁹ John R. Wilke, *U.S. Antitrust Chief Criticizes EU Decision to Reject Merger of GE and Honeywell*, WALL ST. J., July 5, 2001, at A3 (quoting Assistant Attorney General Charles James: “Clear and longstanding U.S. antitrust policy holds that the antitrust laws protect competition, not competitors... [the European Commission’s decision] reflects a significant point of divergence.”)

²⁰ See, e.g., Hal R. Varian, *Economic Scene; In Europe, GE and Honeywell ran afoul of 19th-century thinking*, N.Y. TIMES, June 28, 2001.

competition law is indeed attempting to promote consumer welfare, though in a manner distinctive from, and occasionally diametrically opposed to, the path taken in the United States.²¹ This omission may be fatal within the context of international harmonization, for an effective sine qua non for the successful attainment thereof is that all jurisdictions understand the fundamental goals of each other's systems. Progressive attempts to synchronize laws will undoubtedly encounter many obstacles if both sides do not enjoy full knowledge of the other's starting point.²²

In this regard, it is most certainly not helpful when commentators on one side condemn a body of the law without understanding the source of the divergence in question. Such simplistic criticism serves only to engrain a fundamental view, in this case with respect to how best to promote consumer welfare, which is perhaps anachronistic. Interestingly, nor is it helpful when European officials proclaim an approach to consumer welfare analogous to that followed in the United States if such an analogy is, in fact, inappropriate. In other words, there is reason to believe that recent statements by high-ranking European officials may be somewhat nugatory, as they are not made in the context of a concomitant aspiration to narrow the prevailing wisdom in Europe regarding the role of consumer welfare so as to more closely match the jurisprudence in the United States.²³ It is submitted that such recent, pro-claimed statements are more strongly

²¹ See, e.g., Thomas J. Horton & Dr. Stefan Schmitz, *supra* note 6.

²² Charles A. James, *supra* note 12 (“Cooperation alone will not resolve some significant areas of difference among antitrust regimes that must be addressed if we are to maintain the integrity of antitrust on a global stage.”)

²³ See, e.g., Neelie Kroes, European Competition Policy – Delivering Better Markets and Better Choices, (15 Sept. 2005), at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/512&format=HTML&>

indicative of a fear of being criticized abroad than they are of a fundamental shift in policy. Take, for instance, the recent comments of the European Competition

Commissioner, Neelie Kroes:

“I am aware that it is often suggested that – unlike Section 2 of the Sherman Act – Article 82 is intrinsically concerned with “fairness” and therefore not focused primarily on consumer welfare...

My own philosophy on this is fairly simple. First, it is competition, and not competitors, that is to be protected. Second, ultimately the aim is to avoid consumers harm.”²⁴

At first glance, this is tremendously encouraging and could be construed as a commitment on the part of the head of the European competition authority to actively shape European antitrust law into a body of principles more akin to those in the United States, by adopting the principal tenet of the Chicago School – protecting consumers, but not competitors. However, given the history of EC competition law, there is reason to be skeptical. In addition, and in the context of the above comments, Neelie Kroes emphasized that: “it is not our intention to propose a radical shift in enforcement policy.”²⁵

Nevertheless, insofar as these remarks evidence some desire within the Commission to apply European competition rules in a manner more firmly guided by the economics of industrial organization, there is reason to take heart.

aged=0&language=EN&guiLanguage=en (“Consumer welfare is now well established as the standard the Commission applies when assessing mergers and infringements of the Treaty rules.”)

²⁴ Neelie Kroes, Preliminary Thoughts on Policy Review of Article 82, (23 Sept. 2005), at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML&aged=0&language=EN&guiLanguage=en>

²⁵ *Id.*

In contrast to some of the simplistic criticism of the European approach, this paper shall attempt to demonstrate that the divergence in policy between the two jurisdictions rests on something quite subtle and reflects, in part, Europe's continuing adherence to the basic tenets of the Freiburg School, the details of which shall be discussed momentarily. It shall be argued that the European authorities have indeed attempted to employ competition law to maximize consumer welfare, but that such attempts have occasionally been guided by a theory in direct contradiction to the basic teaching of the Chicago School. A natural, and highly important, off-shoot of this insight will relate to the relative wisdom of employing these conflicting ideologies, particularly with respect to the new economy.

This last question will bring us full circle and to the ultimate conclusion that, although perhaps suffering from myopia in failing to realize that protection of competitors from one another is not the goal of EC competition law, but rather a consequence of the manner in which it seeks to promote consumer welfare, the criticism emanating from the United States may nonetheless be justified insofar as it demonstrates that the European definition of consumer welfare is no longer – if it ever was – appropriate in light of modern economic theory.

Therefore, the first step, after extrapolating the foundational features of the Chicago and Freiburg Schools, will be to make a definitive inquiry as to the relative advantages of the two schools – broadly defined – and to make an argument for the adoption of an optimal

route. This exercise will provide two benchmarks for those seeking international harmonization, namely the identification of the source of divergence, as well as the best route away from this point. In this regard, price theory will be demonstrated to be the key. It will be argued that the EC's expansionist definition of consumer welfare is no longer appropriate, particularly with respect to the emergence of the new economy.²⁶

Having concluded that consumer welfare, defined in the economic sense, ought to be the sole guide in employing competition law, the second step will be to examine the preceding theory and conclusions within the context of particular aspects of antitrust jurisprudence. In this regard, it is submitted that the roots of divergence can be most accurately delineated, and the optimum approach identified, when ascertained from the perspective of a select number of confined areas of competition law. The same route could conceivably be undertaken within the realm of any number of alternative business practices and the legal reactions to them, but predatory pricing, refusals to supply and product tying provide the ideal test cases.

It is the ultimate contention of this paper that the fundamental distinction between the EC and U.S. competition regimes relates not to whether the protection and promotion of consumer welfare should be the ultimate aspiration of antitrust policy, but on opposing views on how best to meet this goal. In other words, there is evidence that the difference between the two regimes is not as to what end to employ antitrust law, but as to how best

²⁶ This conclusion is by no means inescapable. *Cf.* Thomas J. Horton & Dr. Stefan Schmitz, *supra* note 6 (concluding that the DoJ and FTC will have to “become more responsive to the new wave of economic liberalism in future antitrust enforcement efforts” by making a move toward the European model of promoting consumer welfare “or risk losing their historical positions as the leaders of worldwide antitrust enforcement efforts.”)

to get there. This is an encouraging insight and one that is obscured by the kind of uncritical criticism that has been leveled upon the EC by various U.S. commentators. It is encouraging because, each having recognized that the other desires the same outcome, it is merely a matter of debate and academic discourse as to whose approach, or whether an amalgam of both approaches, should emerge as the sole standard by which to employ the principles of competition law.

Yet, at a pragmatic level, it is undeniable that significant difficulty lies ahead in harmonizing the laws of the respective jurisdictions. This difficulty emanates from the fact that the ultimate divergence is with respect to political policy and any major alteration in course will require a fundamental shift in political thinking. Nevertheless, achieving the goal of harmonization need not be quixotic and it is hoped that the following academic study will be ultimately reflective of a larger, self-critical drive toward achieving harmonization.

- *The Pertinent Schools of Jurisprudence*

This Section begins by looking to the foundations of U.S. antitrust law, with particular emphasis being placed on the rise of the Chicago School and the subsequent, widespread acceptance of its teachings, qualified only by the corrections of post-Chicago economics. The discussion relating to the above will, by design, be compendious, given the vast

literature already available on the subject and the ubiquitous understanding of the modern development of U.S. antitrust policy. Moreover, the focus will not be historical for a definite standard has emerged as dominant and has been applied in a largely unqualified manner.²⁷ Thus, given this paper's focus on harmonization, there seems little reason to recount defunct, historical details of American antitrust which have been largely discredited by the modern law. Instead, an accurate overview of the approach taken in America will suffice.

In contrast, the historical context to European law, and the various jurisprudential foundations which underlie it, continue to have a significant impact on the substantive law. Thus, far more attention will be paid to the sources and evolution of EC competition law, for, in addition to their continuing relevance, the significance of these facts have often escaped academic criticism and yet play a role of the most fundamental importance in explaining the divergence between EC and U.S. antitrust law.

- *The Chicago School*

It is difficult to exaggerate the importance of the Chicago School of economic thought on the development of competition policy over the past thirty years. This paper will not seek to recount the intricacies of the school in detail, for they are already well understood.²⁸

However, a compendious discussion of the fundamental tenets of the school and the

²⁷ Certain aspects of U.S. antitrust policy— including product tying – remain inconsistent with Chicago and post-Chicago economics, but these are part of a clear minority.

²⁸ See generally Richard A. Posner, *supra* note 5.

influence it has had on antitrust law provide the necessary foundation from which to consider the nature and direction of competition policy on both sides of the Atlantic.

In order to understand the Chicago School approach to antitrust, one must appreciate the economic objections to monopoly, for it is against such evils that Chicagoans seek to employ competition law.

- *Objections to monopoly*

The basic objection to monopoly results from the profit-maximizing strategy pursued by an undertaking which is unconstrained by competition, both actual and potential. In maximizing profits, a monopolist will produce at the point where the marginal cost of producing another unit of output equals the marginal revenue which would be gained by selling that unit.²⁹ As a monopolist faces a downward-sloping demand curve, the price it charges for a given unit will necessarily be larger than the marginal cost of producing that unit.³⁰ As a result, the monopolist earns positive economic profits.

Why the objection? There are two fundamental reasons. First, by charging a price above marginal cost, a deadweight loss is created for society in the form of foregone transactions that would have taken place but for the supracompetitive pricing.³¹

Essentially, there are consumers who value the product or service at a level at or beyond

²⁹ See CARLTON & PERLOFF, MODERN INDUSTRIAL ORGANIZATION, at 91.

³⁰ *Id.* at 89.

³¹ See, e.g., JEFFREY M. PERLOFF, MICROECONOMICS, 2d Ed at 357 – 361; WALDMAN & JENSEN, INDUSTRIAL ORGANIZATION, 2d Ed at 42 – 44.

the marginal cost to society of producing it, but who are nevertheless denied access to it. As a result, there is a loss in value as some consumers satisfy their demand by switching to goods that require more of society's scarce resources to produce.³² In this sense, perverse incentives are created: a consumer believes he is acquiring an equivalent product, but in fact is purchasing a product that costs society more to produce.³³ This is the necessary consequence of a restriction in industry-wide output and hence, in many analyses of allegedly anticompetitive practices, a competition authority or court will look to empirical and theoretical evidence of whether or not the challenged practices are output-enhancing or output-restricting. The answer to this question will necessarily provide an insight into whether deadweight loss is decreasing or increasing.

The second objection to above-marginal cost pricing is that it creates perverse incentives on the part of a would-be monopolist to expend resources on acquiring and maintaining a monopolistic position. At the limit, such an undertaking would be willing to spend a sum equal to the discounted present value of its expected monopoly profits on obtaining that position.³⁴ This behavior is known as rent-seeking and such expenditure constitutes social waste.³⁵

A further concern, which is often articulated, is known as x-inefficiency. X-inefficiency refers to the idea that a monopolist, which does not have to remain competitive against rivals to stay in business, has less incentive than a competitive firm to be efficient by

³² See POSNER, *ECONOMIC ANALYSIS OF LAW*, 6th Ed at 278.

³³ See RICHARD POSNER, *supra* note 2.

³⁴ *Id.*

³⁵ See, generally, POSNER, *supra* note 32, at 279 – 280.

minimizing its costs.³⁶ Whereas the first two concerns outlined above are acknowledged as genuine by most economic commentators, the concept of x –inefficiency is somewhat more controversial.³⁷ Specifically, many feel that the underlying tenets of the concept are contradictory: insofar as it is assumed that a rational firm is a profit-maximizer, the assumption that a monopolist declines to maximize profits by failing to minimize costs is inconsistent with the underlying assumption.³⁸ Nevertheless, the concern is sufficiently well-known as to justify its inclusion, albeit accompanied with a qualification.

- *The Arguments of the Chicago School*

The Chicago approach to antitrust policy is aimed solely at avoiding the various evils associated with monopoly identified above. Therefore, the twin aims of maximizing consumer welfare and allocative efficiency emerge as the combined source of competition policy. To achieve these aims, Chicagoans look to price theory as the means by which to inform the construction of efficiency- and wealth-maximizing rules.

The result of such an application of price theory was a surprising discovery – virtually all business practices condemned by the law, particularly unilateral actions, were benign when construed economically. Aaron Director and others at the University of Chicago quickly discovered that the explanations put forward by the courts for business conduct

³⁶ *Id.* at 281.

³⁷ *See, generally*, RICHARD POSNER, *supra* note 2 at 18.

³⁸ *See* CARLTON & PERLOFF, *supra* note 29, at 94 (“Monopolies want to maximize profits, and the only way a firm can do so is to minimize its costs at its chosen output level.”)

believed to be objectionable could not withstand economic and logical scrutiny.³⁹ Only horizontal price fixing and horizontal mergers of considerable size were regarded by the Chicago School as being worthy of condemnation.⁴⁰

Diametrically opposed to the Chicago approach is the protection of inefficient competitors against their more efficient, generally larger, rivals. Such protection serves only to frustrate the attainment of efficiencies and to perpetuate the existence of inefficient business whose presence in the market is socially wasteful. Chicagoans therefore prescribe a Darwinian approach to competition policy and a concomitant faith in the ability of natural market forces to ensure efficient outcomes more readily than can judicial intervention.

The message that the competitive process is best furthered by refusing both to protect competitors and to prevent their exclusion from markets as a result of competitor action may seem, at first glance, somewhat paradoxical. But the paradox is resolved by FTC Chairman Deborah Platt Majors, who recently explained:

“I often am asked, particularly in Europe, “how it is that we can have competition without competitors?”

Good question. We support competition because it will lead to efficiencies. But competition can be fierce and someone may “lose.” We do not seek to prop up the “loser” just to keep it in the game. And we do not seek to tame the competition,

³⁹ See, e.g., Aaron Director & Edward Levi, *Law and the Future: Trade Regulation*, N.W. U. L. REV. 281 (1956).

⁴⁰ See generally Bork, *supra* note 3, at 221 (“mergers of up to 60 or 70 percent of the market should be permitted.”)

through anticompetitive regulation or enforcement, to assist a rent-seeking rival.”⁴¹

The Chicago School has been immensely influential under U.S. law, particularly during the 1980s, and although its extreme conclusions calling for general per se legality have been undermined by “post-Chicago” advances,⁴² it seems clear that Chicago’s lasting effect will involve economics being viewed as the appropriate source of U.S. competition law.

As is widely observed, and as will become readily apparent, the Chicago School has not enjoyed the level of acceptance in Europe that it has commanded across the Atlantic.⁴³ This is presumably due to the fact that the Chicago approach is undeniably harsh in application and notions of general equity, in addition to the socioeconomic policies to be discussed shortly, likely constrain European policy setters. The process of competition by which consumers benefit is unforgiving and “punishes the unfortunate as well as the inefficient.”⁴⁴

Nevertheless, the manner in which inefficient competitors give way to their superior rivals is a simple manifestation of Darwinian theory in action and allowing unfettered competition has overriding advantages. It falls to economists to counter highly influential stakeholders by advocating the superior, though not immediately apparent, benefits of allowing competition to thrive unhindered. Justice Easterbrook writes most succinctly:

⁴¹ Remarks by Federal Trade Commission Chairman Deborah Platt Majoras on “U.S. antitrust practice -- how does it affect European Business?” (Apr. 7, 2005), at <http://www.useu.be>

⁴² See generally Herbert Hovenkamp, *supra* note 2.

⁴³ See, e.g., Thomas J. Horton & Dr. Stefan Schmitz, *supra* note 6.

⁴⁴ ROBERT BORK, *supra* note 3.

“[A] producer's loss is no concern of the antitrust laws, which protect consumers from suppliers rather than suppliers from each other. If [the practice in question] should be called unfair competition, it is nonetheless *competition*. Competition is ruthless, unprincipled, uncharitable, unforgiving-and a boon to society, Adam Smith reminds us, precisely because of these qualities that make it a bane to other producers... the plaintiff's complaint is too much competition (injuring producers) rather than too little (injuring consumers). Entertaining claims of excessive competition would undermine the functions of the antitrust laws.”⁴⁵

Adherence to these Darwinian principles has been far from unqualified in Europe. This is so for a number of reasons, the most obvious of which relates to equity, by which competitors are protected against the unfair actions of their more powerful rivals. More subtly, however, a number of unique jurisprudential foundations underlie EC competition law which bear significant explanatory power.

The following pages trace the highly important philosophical foundations of EC competition policy so as to explain Europe's general hostility to an unqualified application of Chicago principles.

- *The Protection of Politically Influential Businesses*

Antitrust law, by the very nature of the subject matter it seeks to regulate, raises sensitive political issues. Foremost amongst these is the affinity many people have for family-run, small business, regarding it both as a source of livelihood for the fine people who run

⁴⁵ See, e.g., *Stamatakis Industries, Inc. v. King*, 965 F.2d 469, 471 (1992).

them and as a good within society, providing a more human counter to, what is perhaps perceived to be, the increasingly impersonal nature of large corporations. Politically charged situations often arise when the entry of a large corporation into a neighborhood or larger market traditionally served by family-owned business results in the displacement of the latter by the former. Strong sympathies arise in the eyes of the public for the plight of the small business-owner trying to provide a living for his family. Such sympathies are, of course, both valid and understandable. Being a function of the political process, it is hardly surprising when antitrust law begins to incorporate such political sympathies in its jurisprudence.

Nevertheless, the Chicago School has condemned the employment of competition law for these purposes, referring to the kind of political empathy that motivates it as “uncritical.”⁴⁶ While the loss caused by the arrival of large, efficient corporations is evident for all to see in the form of the displaced incumbent, the many losses arising from the prevention of such displacement are more subtle and no competition regime can claim to act responsibly if the gains of allowing free entry and competition are not weighed against the losses. This is why dogmatic and simplistic reaction to political sympathies, without factoring in the concomitant benefits, could be deemed inane.

So, what are the losses inherent in employing competition law to prohibit free competition on the merits when less efficient business will be injured? The first, and axiomatic, loss relates to the economic objections to monopoly highlighted above. By curtailing the expansion of a large firm’s market share to avail of the various efficiencies

⁴⁶ See, e.g., RICHARD WHISH, *supra* note 8.

underlying its production and distribution processes, competition law effectively reduces the level of industrial output, raises the market clearing price and augments deadweight loss. In addition to the myriad of negative effects associated with such loss, the incentive on the part of potentially successful firms to engage in the expensive research and development needed to attain that superiority is blunted, due to the restriction on an efficient firm's abilities to avail of its meliority. Consumers will inevitably lose in the long-run as they are denied access to the fruits of innovation that free competition would have provided them.

Moreover, pragmatic as well as theoretical objections arise. First is the major problem of articulating a coherent and consistent body of legal principles in formulating an antitrust policy protective of politically favored business. Attempting to employ law to such an end is apt to result in a series of diametrically-opposed and self-contradictory principles, which have to be applied in an ad hoc fashion in order to achieve particularized justice.⁴⁷ While this may lead to equitable outcomes in certain, particular cases, in the long run the lack of legal certainty is likely to lead to further blunting of incentives on the part of market actors, whose efforts are value-adding to society.

Consider the case of a court employing competition law in furtherance of politically-favored business to prohibit the acquisition of a small business by a larger corporation.⁴⁸

Prima facie, such a prohibition would seem to be in the best interests of the small business-owner specifically and the small business community generally. The owner may

⁴⁷ See generally Bork, *supra* note 3.

⁴⁸ See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

continue in business unperturbed. Yet, closer analysis demonstrates the clear fallacy of this reasoning. In attempting to aid the small business-owner now, the court may inadvertently hurt the community as a whole by reducing the expected return of starting one's own business. With such acquisitions prohibited, the small business owner cannot sell his company. Moreover, it is not clear that the owner purportedly protected by the court's decision will, in fact, be left better off. More likely, the larger firm will enter the market regardless and, instead of acquiring his business, will simply price him out of the market. The court's decision, while enacted with the intention of aiding the small businessman's plight, has in fact hurt him.⁴⁹ To prevent ensuing damage, the court would have to forbid pricing below the prevailing price set by the small business owner. But this is tantamount to banning competition entirely and represents such a strong application of the protectionist argument that no court could, or would, ever employ it.

While it may be concluded that the costs of applying competition rules in protectionist fashion are likely to exceed the benefits, this does not mean that the Chicago view prevails in practice. In contrast, this all leads to an unavoidable clash between economists and politically influential stakeholders. While the United States has seen an almost unqualified victory for the economic view, with the Robinson-Patman Act against price discrimination providing a quite dramatic exception with politically favored, small business interests winning out,⁵⁰ both current European and historical American law appear to display an uneasy balance between the two. Perhaps the clearest illustration of protectionism emerges not from Europe, but from the United States during the Warren

⁴⁹ See generally RICHARD POSNER, *supra* note 2, at 126.

⁵⁰ 15 U.S.C. § 13.

Court era. Ironically, the case so often cited for the Supreme Court’s proclamation that “antitrust protects competition, not competitors” is *Brown Shoe*, perhaps the quintessential United States judgment in favor of the protection of individual competitors!⁵¹

The uneasy balance between economics and politics creates a significant danger of courts following the *Brown Shoe* approach – adhering to the political goal, whilst proclaiming adherence to the other. It follows that one must be skeptical of a court’s alleged unqualified adoption of the economic approach, for the countervailing political influence is considerable and can be expected to permeate through the judicial process.

Of fundamental importance to this Section, therefore, is the identification of whether EC competition law is currently applied to protect competitors as a goal in itself or whether such protection is the by-product of a larger purpose. Moreover, if there is a distinction, the question must also be asked as to whether the distinction matters. The key to achieving all of this is to look to the role of the Freiburg School under European law.

A final manifestation of protectionism arises with respect to the deliberate frustration of politically disfavored business. For example, there are those who believe that the fundamental reason for the prohibition of the GE/Honeywell merger by the European Commission was political. In other words, it has been argued that had the strengthening

⁵¹ Immediately following the Court’s declaration cited above, it held: “But we cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned businesses.” *Brown Shoe*, 370 U.S. 294, 344 (1962).

of two European companies been at issue, the merger would presumably have been approved.⁵²

Nevertheless, there is reason to be skeptical of such political conspiracy theories. For one, there has been an unprecedented level of international cooperation between the U.S. and EC and it seems strange indeed that such cooperation would suddenly be dispensed with for no good reason. Second, and more importantly, the reasoning behind the Commission's decision with respect to GE/Honeywell makes perfect sense when construed in light of the evolution of European competition law, the various philosophies pervading it, and the case law interpreting it. This will become clear momentarily when the Freiburg School is considered and the practical differences between ordoliberalism and mere protectionism identified.

As has been made clear, insofar as protectionist principles still pervade European law, there is strong ground for repealing them. A more difficult argument awaits with respect to the suitability of Freiburg ideology.

- *The Overriding Importance of the Market Integration Objective*

⁵² See, e.g., *Europe to GE: Go Home*, WALL ST. J., June 15, 2001, at A14 (“In the Honeywell case, novel antitrust theories have been dreamed up simply because it would be unthinkable to let a large U.S. company go about its business unmolested.”)

Before considering the Freiburg School, however, it is necessary to discuss what is perhaps the most important function of EC competition law, namely facilitating the furtherance of single market integration. The goal of realizing a single, integrated market through the working of a legal competition framework is unique amongst the world's antitrust regimes. In this sense, European antitrust law seeks to serve a goal which has no parallel under U.S. law and this observation alone necessitates the question of whether complete harmonization of law between the EC and U.S. is desirable, let alone achievable. This challenge shall be considered in due course.

A ubiquitous and unwavering trend in EC competition law has involved the unhesitating condemnation of any business practice seen as creating an obstacle to inter-Member State trade or in a manner otherwise likely to frustrate the integration of the single market. An example of such an instance is the case of *Consten & Grundig*, where a manufacturer granted one of its dealers an exclusive territory (France).⁵³ Refusing to hear any economic justifications, the ECJ condemned the agreement as being contrary to Article 81 EC due to its impediment to single market integration.

Yet, it may be seen that this is a highly debatable proposition, for it ignores such factors as interbrand competition and the fact that implementation of the distributorship could actually have *increased* trade between France and other countries. Here the Court can be seen suffering from myopia. It is indeed true that the restriction imposed by the distributor created an insurmountable obstacle to those wishing to engage in intrabrand competition in France from other Member States. Yet, the Court did not consider the

⁵³ Joined Cases 56 & 58/64, *Consten and Grundig v. Commission*, E.C.R. 299 (1966).

likely long-term effect of the restriction on net, interbrand competition between Member States. It may well have been that the distributorship was a risky venture and the distributor required intrabrand protection in order to enable him to rationally take that risk. The restriction, while creating an intrabrand obstacle to the single market, would seem to have facilitated an increase in interbrand competition. This elevated level of competition would result in higher demand and, hence, higher output. *Ceteris paribus*, one would expect a higher degree of inter-Member State trade, hence furthering the goals of the European Community.

This demonstrates how the European Court's dismissal of economics may have been a mistake. The economics of a particular situation must always be assessed to ascertain whether a short-run barrier to integration may, in fact, lead to long-run furtherance of the single market. It cannot be confidently stated, however, that a pure Chicago approach in furtherance of allocative efficiency will *always* further the single market integration principle. In instances where elevated levels of consumer wealth within a particular part of the European Union are likely to have a deleterious, long-run effect on free trade between Member States, the European Court may be right to strike down the practice. But this power must be tempered, without exception, by two considerations: (1) the level of integration that has already taken place over the history of the European Union renders the principle less worthy of unqualified superiority as in the past,⁵⁴ & (2) augmented allocative efficiency may indirectly further the goals of the single market.

⁵⁴ Though this point too must be considered in light of the recent enlargement of the European Union to encompass twenty five Member States, which may call for stringent enforcement of integration principles with respect to these new countries.

Interestingly, the single market imperative shares many of the same features in application as the Freiburg School, particularly with respect to fairness and the elimination of exclusionary practices.⁵⁵ By preventing mergers likely to increase concentration, even if not prices,⁵⁶ and by holding illegal those unilateral and concerted practices designed to make entry into a particular market more time-consuming or costly, even where those practices increase efficiency, EC competition law attempts to ensure that market actors in various states are granted equal and unrestricted access to the relevant market.

Nevertheless, and somewhat counter-intuitively, it is submitted as the major insight of this Section that an application of an economic approach to antitrust policy may, in fact, serve to further the important European goal of integration, while at the same time promoting a more competitive and efficient single market. In other words, the presence of barriers – artificial and otherwise – may in many circumstances serve to further long-run integration, even if short-term entry is delayed or frustrated. Impressionistic assessment of obstacles to single market integration may not only do a disservice to that goal, but also frustrate the emergence of an efficiency-enhancing competition policy.

⁵⁵ See, e.g., David J. Gerber, *supra* note 16. (“Perceived fairness is central to the entire project of European integration. An even and thus “fair” playing field for all market participants has been seen as an essential condition for integration of the European market. The central assumption was that only where the market is perceived to be fair would national decision makers be willing to surrender some of their control over markets and thus allow economic integration.”)

⁵⁶ Compare U.S. Dep’t of Justice Press Release, Justice Department Requires Divestitures General Electric and Honeywell (May 2, 2001), at http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm, with *General Electric/COMP/M.2220*, EC Decision of July 3, 2001, at http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf.

- *The Freiburg School*

The Freiburg School of ordoliberal thought plays a central role in explaining key aspects of substantive divergence between the competition regimes of the EC and U.S..

Unfortunately, the teachings of the school and the role it has played in shaping antitrust policy in Europe have largely escaped the attention of American commentators and practitioners.⁵⁷ Such a lack of attention is an explanatory factor for the kind of misguided criticism cited above with respect to both GE/Honeywell and the proclaimed desire on the part of the Commission to protect competitors at the expense of consumers. Given the relatively obscure role of ordoliberal thinking and the importance it plays both with respect to the future development of EC competition law and to international harmonization, it is necessary to devote considerable time to the subject.

The Freiburg School's teachings are decidedly more subtle than mere protection of politically favored business and advocate a form of competition policy designed to promote consumer welfare through the guaranteed provision of eclectic goods and services, coupled with a libertarian right of access to markets, for both consumers and businesses. Inherent in this philosophy is a constraint on mass accumulation of power and

⁵⁷ See, e.g., David Gerber, *Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New" Europe*, 42 AMJCL 25 (1994) ("Despite its enormous importance, ordoliberal thought -- and German neo-liberal thought generally -- has received little attention in the English-speaking world, and it remains all but unknown in the United States.") In 1983, one leading German commentator noted that "English language material concerning the Freiburg School as a whole has not been found." Wolfgang Fikentscher, II *Wirtschaftsrecht* 40 n. 59 (1983).

capital in the hands of any one entity. Essentially, ordoliberalism calls for ease of access to information, freedom of choice and the equitable distribution of wealth – three features that one would strain, employing any definition, to find unrelated to the notion of consumer welfare. In sharp contrast, indeed, the Freiburg School is very much concerned with promoting the well-being of consumers and it seems clear that its style of thinking has been incorporated within the evolution of EC competition law. Yet, it is equally clear that an irreconcilable tension may sometimes arise between furthering the goals of the Freiburg School and maximizing consumer wealth in a manner consistent with Chicago. It is this tension that has led, in part, to the divergence in substantive antitrust law witnessed today.

- *The Roots of the Freiburg School*

The substantive arguments of the Freiburg School cannot be understood without reference to their historical development.⁵⁸ Neoliberalism in Germany arose out of the debacle that was the Weimar Republic and developed through the totalitarian and oppressive Nazi regime. The neoliberal thinkers were repulsed by the economic and legal structure that permeated the Weimar Republic and were equally aghast at the policies – economic, social and political – of the Nazi era. Central to neoliberal thought was the goal of preventing the emergence of the kind of institutional and socio-economic failures that led to the turbulent and tragic history in question.

⁵⁸ For an excellent discussion of the rise of ordoliberal thought, on which the author strongly relies, see David Gerber, *supra* note 58.

The Weimer Republic arose following the controversial end to World War I, which many Germans viewed with resentment, having held the belief that Germany was not in fact losing the war. Much anger and bitterness was directed toward the Weimar Republic that arose in the context of the pervasive mood of the day. Given this fact alone, the new governmental structure faced grave difficulties. Perhaps inevitably, the institutions of the Weimar Republic lacked legitimacy in the eyes of the public and this led to the concomitant failure, and perhaps usurpation, of the judicial process. “Law increasingly came to be viewed as a tool of power rather than a reliable social institution,”⁵⁹ with the ubiquitous nationalist support in the courts resulting in a number of miscarriages of justice against socialists. This culminated in a profound public dissatisfaction and lack of faith in the institutions of the government.

The economic structure of the Weimar Republic was similarly disastrous. In addition to the ravages to the economy of war, the country faced heavy – some would say excessive and unfair – reparations and an unprecedented inflation rate. Faced with such an economic climate, it will be of little surprise to learn that the firms comprising the various markets within the Republic sought action in concert to survive and to maintain profitability. The result was an increasingly severe level of cartelization and a concomitant predation of any firms wishing to engage in free competition.

Such was the context of the Nazi assumption of power in 1933.

⁵⁹ *Id.* at 27.

It was in 1933, during this chaotic time, that two lawyers – Franz Bohm and Hanns Grossman – and one economist – Walter Eucken – crossed paths in the relatively secluded town of Freiburg, only to discover “that they had similar readings of the failing of Weimar and similar views of what to do about it.”⁶⁰ They readily attributed the socio-economic and political breakdown of the Weimar Republic to the fatally flawed legal institutions and the resulting failure to check the abusive exercise of economic power by cartels and monopolists. Due to Freiburg’s seclusion, members of the School were able to pursue their scholarship throughout the Nazi era and, as a result, were uniquely placed at the end of the war to provide a socio-economic model upon which to rebuild West Germany – a model, of course, that was pleasing to the United States given its distance from the extreme politics of the preceding era and those of the Soviet Union.

- *The Central Tenets of Ordoliberalist Thought*

Given the historical context to the rise of the Freiburg School, the central tenets of ordoliberalist thought are by no means shocking. As eloquently and succinctly explained by David Gerber:

“Against the backdrop of chaos, devastation and amassed power, the ordoliberals set out to create a tolerant and humane society that would protect human dignity and personal freedom. Drawing on the central values of classical liberalism, they envisioned a society in which individuals were as free as possible... The Weimar experience led ordoliberals to demand the dispersion of not only political power, but economic power as well. For most, this meant the elimination of monopolies. For others, such as Wilhelm Ropke, the concentration of economic resources was

⁶⁰ *Id.* at 29.

an evil unto itself; they sought an economy composed, to the extent possible, of small and medium-sized firms. Both groups tended to view economic concentration with suspicion and sought to protect the existence and the economic freedom of small and medium-sized businesses.”⁶¹

Thus, the Freiburg School does not seek to spurn the competitive process so as to protect politically influential business or “state champions” at the expense of consumers. Rather, it takes a hostile view to the accumulation of economic power within the control of a single entity, recognizing such concentration as a potential danger to consumers and society at large; such views emanating from the empirically unquestionable harm having resulted from unchecked concentration during the Weimar Republic. Most interestingly, this does not mean that the ordoliberals opposed competition. Quite to the contrary, they embraced it, viewing an effective competitive process as being at the heart of a socio-economic structure that would maximize consumer welfare and political stability, so as to avoid the possibility of recidivism. Walter Eucken, a key figure in the rise of the Freiburg School,⁶² envisioned an intense competitive process as being at the heart of reform. Indeed, the greater the degree of competition, the more closely reality would match the ordoliberal ideal.

Consistent with those who view the source of competition law as allocative efficiency,⁶³ ordoliberals view price- or output-fixing concerted action as inimical to consumer welfare. Indeed, insofar as both schools of thought recognize the possibility of improper

⁶¹ *Id.* at 36.

⁶² *Id.* at 39 (“Called by Friedrich Hayek “the most serious thinker in the area of social philosophy that Germany had produced in a century,” Walter Eucken was the primary architect of the methodological and philosophical framework of ordoliberalism.”)

⁶³ *See, e.g.,* ROBERT BORK, *supra* note 3; RICHARD POSNER, *supra* note 2.

exclusion of rival firms,⁶⁴ both agree that prohibition of the offending practice is in consumers' best interests.

Nevertheless, the function and role of the competitive process conceived by the Freiburg School is quite remarkably different, in many respects, from that pronounced by the Chicago School, which seeks to maximize consumer wealth, even if achieving that requires monopolization by the most efficient competitor. Rather, under the ordoliberal view enunciated by Eucken, monopolization is to be avoided at all costs and access to the markets must be guaranteed. No emergence of excessive economic power, or abuse of such clout against rivals and potential entrants, can be tolerated, for it was precisely such unchecked action that provided the backdrop for Germany's tragic situation following World War I.

An excellent contrast between the role of competition as envisioned by the Freiburg School and those adhering to an economic approach is provided by Calixto Salomão Filho, who writes:

“For the Ordo-liberals, the great advantage of the competition system is the fact that through the transmission of information and freedom of choice, it allows the discovery of the better available options and the most rational behaviors. This is Hayek's classic definition of the competition system as a *Entdeckungsverfahren* (discovery process). The existence of a free choice process and discovery of the best options in the market depends on not only the existence of a price that is not altered by artificial offer and demand conditions, which would represent the

⁶⁴ Richard Posner has acknowledged the possibility of a firm excluding “an equally or more efficient rival,” though this prospect is not recognized by Robert Bork. For a discussion of this issue, see Michael A. Carrier, *Antitrust After the Interception: Of a Heroic Returner and Myriad Paths; A Review of Richard Posner, Antitrust Law* (2d ed. 2001), (Mar. 2002), at www.antitrustsource.com (book review).

marginal utility of a product, as the Neoclassics wish, but also on the existence of actual or potential possibilities of choice among products, based on price, quality, regional preferences, etc. The possibility of choice has its own value.”⁶⁵

In essence, the role of competition under the Freiburg philosophy is to prevent cartelization, monopolization and excessive concentration, to guarantee open access to markets, to facilitate the free movement of goods and information and to generate cooperation, coherence and political stability.⁶⁶

- *The Incorporation of the Freiburg School into EC Competition Law*

In some respects, it would initially seem surprising that a German school of socio-economic thought, developed in large part during the time frame of, albeit in opposition to, the Nazi regime, would come to pervade European competition policy. Yet, closer inspection reveals a number of reasons why Germany did indeed play a particularly influential role with respect to the development of EC competition law.⁶⁷ First, with the end of the war and in a political climate seeking economic cooperation, the Freiburg School was uniquely equipped with socio-economic theories capable of providing the

⁶⁵ Calixto Salomão Filho, *Legal Theory of Economic Knowledge*, at <http://islandia.law.yale.edu/sela/esalamao.pdf>.

⁶⁶ For a classic statement of the ordoliberal function of competition, see F.A. HAYED, *INDIVIDUALISM AND ECONOMIC ORDER*, Chicago, (The University of Chicago Press 1948) at 106 (“Competition is essentially a process of the formation of opinion: by spreading information, it creates that unity and coherence of the economic system which we presuppose when we think of it as one market. It creates the views people have about what is best and cheapest, and it is because of it that people know at least as much about possibilities and opportunities as they in fact do. It is thus a process which involves a continuous change in the data and whose significance must therefore be completely missed by any theory which treats these data as constant.”)

⁶⁷ See, e.g., David J. Gerber, *supra* note 16 (“Germany has played a special role in the development of competition law in Europe and this role is particularly important for understanding the evolution of fairness concerns.”)

foundation for an economy based on the principles of integration and free market access. Second, during the founding of the European Economic Community, “[m]ost of the leading German representatives... were closely associated with ordoliberalism or at least shared an appreciation of it.”⁶⁸ Third, the Germans unquestionably had the most experience with respect to competition law, having “just passed Europe’s first modern competition statute. As a result, they emerged as leaders in this area – as illustrated, for example, by the appointment of von der Groeben as the first Commissioner for Competition Policy of the European Commission.”⁶⁹

The overall result was that “ordoliberal thought set the tone for thinking about competition law within the Communities.”⁷⁰

We can now appreciate the importance of this school of thought in potentially explaining some of the divergence between the U.S. and EC discussed above. Ordoliberal thinking differs markedly from the economic thinking of the Chicago School and, to the extent that its influence remains strong within Europe, it constitutes a possibly serious obstacle to realizing the goals of global harmonization. It is, therefore, necessary to examine the on-going influence of the Freiburg School in modern European competition law.

First, however, it is important to ask a fundamental question: in what respects, if any, are the goals of the Freiburg School different from those simply designed to protect small and medium-sized firms from their larger, more efficient, rivals? If the distinction is

⁶⁸ *Id.* at 71.

⁶⁹ *Id.* at 73.

⁷⁰ *Id.* at 73.

merely illusory, it will have major ramifications for the analysis conducted heretofore and below.

- *Distinguishing ordoliberal thought from the mere protection of small business*

It is unquestionably the case that ordoliberal competition policy often has protection of weaker business as its effect. The vital question, therefore, is whether ordoliberal thought, for all its ostensibly sophisticated theoretical foundation, is functionally equivalent to the simple protection of politically favored business – an object discussed above and found, for a number of reasons, to be disfavored. After all, what does it matter if protectionism is the goal or effect of a practice when the end is the same?

The conclusion seems inescapable that, in many instances, there is little practical difference between the two in terms of effect. Whether a court wishes to protect weaker business against more efficient rivals on either the ground that said business is politically favored, or on the ground of fairness, the legal ruling is likely to be analogous to that applied in furtherance of ordoliberal principles seeking to avoid concentration. So construed, the preceding discussion of the role of Freiburg in Europe serves an explanatory role only and is, as a practical matter, defunct. The American criticism cited in Section One as short-sighted could be astute after all.

However, it is submitted that an important difference between these two instructive theories can and does arise. When the decisive factor is consumer welfare, as defined by

the Freiburg School, rather than protection of business, one would expect to see instances of increases in consumer wealth following a firm's employment of an efficiency-enhancing practice to be weighed against the concern of elevated levels of concentration in the future. Such an approach may lead, in some instances, to a clear divergence between protectionist and ordoliberal principles. Of course, where a practice leads to the elimination of all incumbent competition, though higher consumer wealth, one would expect a Freiburg court to find the resulting concentration to be prohibitively malignant. Yet, at the margin, evidence of a court disregarding significant, though not total, harm to incumbent competitors in favor of immediate consumer welfare would provide convincing evidence that Europe adheres to ordoliberal views, as contrasted to a basic principle of protecting competitors as an end in and of itself.

It can now be demonstrated how Freiburg thinking is distinguishable from the protection of politically influential business. Such protection takes place without regard to the best interests of consumers. Protection of less efficient business under ordoliberal thinking is quite different and is grounded in the notion of consumer welfare.

The significance of the Freiburg School in playing a role distinct from mere protectionist principles is evident from a consideration of EC competition law.

First, clear evidence exists that dominant firms can monopolize a market, or otherwise harm competitors, by virtue of its efficiency alone and where consumers benefit.⁷¹

⁷¹ See e.g., GOYDER, EC COMPETITION LAW, (Oxford University Press 4th Ed 2003) at 343 ("it is not the monopoly or quasi-monopoly on its own that can be challenged but its abuse.")

Moreover, dominant firms are permitted to injure their rivals when consumers benefit as a result. Consider the case of *Irish Sugar v. Commission*, where the Court of First Instance held that an undertaking's protection of a dominant position "must... in order to be lawful, be based on criteria of economic efficiency and consistent with the interests of consumers."⁷² Were a purely protectionist approach to be taken by the courts, it is unlikely that a dominant firm would be allowed to injure its rival firms, even on the basis of inherent efficiency. Instead, the CFI here provides an indication of the fact that EC competition law seeks to protect consumers and where the efficiencies enjoyed by a dominant firm are such as to outweigh concerns of concentration, the utilization of such efficiencies should be permitted.

In this respect, EC law is analogous to the law as classically stated by Judge Learned Hand in the United States: "a single producer may be the survivor out of a group of active companies, merely by virtue of his superior skill, foresight and industry... The successful competitor, having been urged to compete, must not be turned upon when he wins."⁷³

Consider also the case of *Atlantic Container Line AB v. Commission*, which held that even an agreement creating a dominant position, to the obvious detriment of the contracting parties' incumbent opposition, can take place without challenge under EC competition law where such acquisition results from superior efficiency that will benefit

⁷² Case T-228/97, *Irish Sugar v. Commission*, 1999 E.C.R. II-2969, [1999] 5 C.M.L.R. 1300, para 189.

⁷³ *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir 1945).

consumers in the long run.⁷⁴ Obviously such an agreement is to the disadvantage of all competitors not privy thereto, but the court looked past the harm to individual competitors to find a concomitant increase in consumer welfare likely to flow from the agreement. This makes the distinction between ordoliberal and protectionist principles explicit. The latter philosophy would condemn an agreement harming other competitors in the market whereas the former would weigh the clear short-run consumer benefit against the possible long-run harm thereto as a result of increasing concentration. Such balancing under the ordoliberal view does not involve a foregone conclusion and where the benefits of rising concentration to consumers are clear, Freiburg-based jurisprudence will permit the acts in question.

In addition, a number of Commission decisions finding certain mergers to be compatible with the common market have also focused on the benefit to consumers of the resulting concentration in elevating the level of competition in the market. So, in the *Saint-Gobain BPB* merger, the Commission concluded that that the bundling likely to take place by the merged entity would compel similar bundling on the part of incumbent competitors in order to survive the enhanced level of competition to the ultimate benefit of consumers.⁷⁵

The fact that European law seeks to protect consumers, and not necessarily competitors, can be made clear employing a number of other explanatory cases, but the most succinct of these must surely be Article 81(3), which allows the exemption of agreements whose

⁷⁴ Case T-395/94, *Atlantic Container Line AB v. Commission*, 2002 E.C.R. II-875, [2002] 4 C.M.L.R. 1232, para 330.

⁷⁵ *See, e.g.*, Commission Decision of 09.11.2005 declaring a concentration to be compatible with the common market (Case No COMP / M.3943 - SAINT-GOBAIN / BPB) according to Council Regulation (EC) No 139/2004 at para 59.

anticompetitive effects are shown to be outweighed by benefits to consumers, as opposed to competitors themselves.⁷⁶

Evidence is provided by Article 81 (3)'s express requirement that a fair share of any benefits from an agreement flow to consumers. This is, once again, consistent with ordoliberal principles, but it is not clear that such a requirement would exist under a purely protectionist regime. In such a context, one would imagine that the requirement under 81(3) would be to the effect that no elimination of competitors would result from the agreement in question. Yet, such is not the case. Instead, the closest provision is that no substantial elimination of competition take place. Is this synonymous with harm to competitors? There is reason to believe that it is not. First, the requirement of "substantial" harm should be noted. Evidently, harm ensuing from an agreement to competitors within a market will not prevent the application of Article 81(3) if it is not sufficiently severe.

Perhaps the clearest evidence that consumer welfare – economically defined – is the fundamental consideration in assessing the legality of potentially anticompetitive agreements is provided by recent Commission Guidelines.⁷⁷ Given that the European Commission is the primary driving force behind EC competition law, evidence of its belief that consumer welfare, as opposed to mere harm to competitors, is the fundamental

⁷⁶ *See, e.g.*, Opinion of the European Economic and Social Committee on the XXXIIIrd Report on Competition Policy – 2003, OJ 2005 C221/1, at 2.3 ("The Commission will express a favourable opinion in cases where agreements between companies do not restrict competition on the relevant markets, and where consumers benefit from the cooperation.")

⁷⁷ Communication from the Commission - Notice - Guidelines on the application of Article 81(3) of the Treaty, 2004 O.J. (C 101) 97, at 93.

standard on which to base a judgment as to the legality of an agreement provides the basis for the confident inference that EC antitrust is primarily concerned with consumers.

In the Guidelines, the Commission goes so far as to stress that efficiencies flowing to consumers from an agreement may be subtle and one must take care to accurately identify and weigh them against the competitive harms identified under Article 81 (1).⁷⁸

The Commission's focus on consumer welfare displayed a strong reliance on economic theory, fully consistent within the context to the Chicago approach, emphasizing that:

“Cost efficiencies may in some circumstances lead to increased output and lower prices for the affected consumers. If due to cost efficiencies the undertakings in question can increase profits by expanding output, consumer pass-on may occur. In assessing the extent to which cost efficiencies are likely to be passed on to consumers...

All factors must normally be considered. Since Article 81(3) only applies in cases where competition on the market is being appreciably restricted... there can be no presumption that residual competition will ensure that consumers receive a fair share of the benefits... it is necessary to balance the two opposing forces resulting from the restriction of competition and the cost efficiencies. On the one hand, any increase in market power caused by the restrictive agreement gives the undertakings concerned the ability and incentive to raise price. On the other hand, the types of cost efficiencies that are taken into account may give the undertakings concerned an incentive to reduce price...

The effects of these two opposing forces must be balanced against each other. It is recalled in this regard that the consumer pass-on condition incorporates a sliding scale. When the agreement causes a substantial reduction in the competitive constraint facing the parties, extraordinarily large cost efficiencies are normally required for sufficient pass-on to occur.”

⁷⁸ *Id.* at 93.

These 2004 Guidelines convincingly prove that EC competition law is far more sophisticated than merely trying to protect competitors. Consumer welfare is at the heart of the process and the Commission makes explicitly clear the fact that economic efficiencies being passed onto consumers is of central importance and that even substantial harm to competitors can be outweighed by elevated consumer wealth. In addition, actual Article 81 (3) decisions demonstrate the importance of benefit to consumers, as opposed to lack of harm to individual competitors.⁷⁹

Given such reliance on consumer welfare, how can one explain the Commission's decision in GE/Honeywell? There, the U.S. Department of Justice approved the merger on the ground of complementary effects likely to follow therefrom. Carlton and Perloff describe the phenomenon as follows:

“[W]hen a single firm prices two complementary products, it takes into account that lowering the price on one product will stimulate demand for the other. This demand effect creates an incentive for the firm to set lower prices for both products than would be set if each product were sold by a different firm. Thus, one should expect lower prices and consumer benefits . . .”⁸⁰

On the basis of such reasoning, the Justice Department approved the merger for being in furtherance of consumer welfare.⁸¹ Why did the European Commission not follow suit? Why did it flaunt economic evidence of complementary effects increasing consumer welfare? Is it

⁷⁹ See, e.g., *Visa International — Multilateral Interchange Fee*, 2002 O.J. (L318) 17, [2003] 4 C.M.L.R. 283 (where the complaints of competitors were rejected in face of consumer-welfare enhancing network effects to be availed of by the agreement). See also *TPS 1999* O.J. (L90) 6, [1999] 5 C.M.L.R. 168, paras 135-138, upheld on appeal by the CFI Case T-112/99, *Metropole Television SA v. Commission*, 2001 ECR II-2459, [2001] 5 C.M.L.R. 1236.

⁸⁰ *CARLTON & PERLOFF*, *supra* note 29.

⁸¹ U.S. Dep't of Justice Press Release, *Justice Department Requires Divestitures General Electric and Honeywell* (May 2, 2001), at http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm.

because the Commission abandoned its focus on consumers and instead adopted protectionist principles, as has been suggested by a number of U.S. commentators? It seems most unlikely. More probable is that the GE/Honeywell decision reflected the Commission's belief that the predicted long-run increase in concentration in the relevant markets would be ultimately harmful to consumers. This is entirely consistent with ordoliberal beliefs and reflects the philosophy that a lack of concentration in a market is likely to a long-run furtherance of consumer welfare. It would appear that the decisive factor in the Commission's reasoning lay in its belief that GE/Honeywell's increased efficiency would lead to the long-run exit of incumbent competitors, with the result that consumers would be denied meaningful choice.⁸² This is a clear manifestation of the Freiburg School's philosophy.

The tension between Freiburg and Chicago principles is very real. In the 2004 Guidelines, the Commission can plainly be seen adopting the latter view, insofar as it is facilitative of the former. Meanwhile, other instances, as illustrated by GE/Honeywell, have seen ordoliberal thinking clearly prevailing when placed in conflict with Chicago. What is certain is that there is more to European jurisprudence than the mere protection of incumbent business. The consumer appears to play the critical role.

- *Questioning the Role of Ordoliberalism in a Modern Europe*

⁸² *General Electric/COMP/M.2220*, EC Decision of July 3, 2001, at http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf.

Having surveyed the various theoretical bases underpinning competition policy in Europe and the United States, the crucially important task of identifying the optimal theory by which to inform antitrust policy arises. Only when a single standard emerges will genuine harmonization be able to take place between the U.S. and the EC. Until that time, cooperation can be achieved and many, indeed most, cases will be resolved in parallel manner, but when instances arise in which the two jurisdictions' differing jurisprudential bases come in conflict, more scenarios reminiscent of GE/Honeywell will occur. Taking as given that both the U.S. and EC share the ultimate desire of maximizing consumer welfare, the challenge is to identify which theory, or amalgam of theories, is most likely to further this goal.

The continued presence of ordoliberal thought within EC competition policy in the 21st century is the major point of contention for this paper. It will be argued that the Freiburg School, while making a valuable and quite proper contribution to socio-economic progress in its historical context, is now anachronistic and stands in the way of economic, political and international progress. Indeed, it is submitted that the fundamental tenet of the Freiburg School – that the competitive process will disintegrate and collapse into a series of monopolized and heavily concentrated industries to the ultimate harm of consumers and society⁸³ – has not been borne out by the realities of the U.S. model. Such a lack of faith in the functioning of the free market may be attributed to the historical

⁸³ *Id.* at 50 (“for Eucken and his colleagues, history -- particularly Weimar history -- had demonstrated that competition tended to collapse... The recurring self-destruction of economic freedom, particularly during the 1920s, was the story that informed their thought relating to competition law... The ordoliberals viewed competition law as a means of preventing this degeneration of the competitive process.”)

context in which ordoliberal thinking emerged. There is good reason to be more optimistic about the self-correcting nature of competition today.

When one appreciates the further point that the various objections to monopolization, highlighted within the discussion of the Chicago School, become reality when efficiency- and consumer-welfare enhancing business practices are forbidden on the grounds of possible future levels of concentration, the conclusion seems almost inescapable that the Freiburg School's influence is no longer appropriate.

The strongest ground for the Freiburg approach relates to the alleged inability of consumers to act in their best long-term interests. However, a careful consideration of this assumption will demonstrate that it is ultimately unconvincing.

It was demonstrated above that protection of less efficient business under ordoliberal thinking is quite different from a purely protectionist view and is grounded in the notion of consumer welfare. How could it ever be necessary to protect consumers from their own free will?, one might ask. Consumers can, and do, shop around for the best deals. If they are attracted to lower prices, even from larger corporations, surely this is a democratic expression of their preference? In such circumstances, one may readily question the role of competition law in creating a barrier to consumers' attainment of those preferences.

Yet, it may fairly be observed that this discussion places a lot of faith in consumers as a group to act in furtherance of their best interests. Perhaps it is useful to relax this assumption and analyze a more paternalistic view. What if consumers suffer from myopia, being attracted to low prices without giving due regard to the level of unwelcome concentration likely to follow in the long run? There is an extensive literature on the problem of low-income segments of society who face significant capital constraints discounting the future at a vastly excessive rate.⁸⁴

Moreover, a classic collective action problem arises. While every consumer may desire a lack of excessive concentration in the future, every consumer also has an incentive to free ride off the actions of others. In other words, each consumer maximizes his utility by availing of the low prices being offered by the increasingly large corporation whilst relying on other consumers to spend greater amounts of money purchasing the same goods from smaller, less efficient, businesses. This is a classic prisoners' dilemma situation. Each consumer's dominant strategy is to purchase from the large firm at lower prices, for if all other consumers purchase from small stores at high prices, the consumer in question maximizes his possible payoff – lower prices now and a lack of excessive concentration in the future. If other consumers purchase from the large, efficient, firm, the consumer in question will not be unilaterally capable of preventing the future state of concentration and may as well maximize his utility by availing of the low prices now. As

⁸⁴ See, e.g., Kirk R. Smith, *Poverty and Climate Change: Cause, Effect, or Effect Modifier*, at http://ehs.sph.berkeley.edu/krsmith/publications/03_smith_3.pdf (“It is nearly a tautology to say that poor people and their nations generally act as if they have short time horizons or, in the jargon of the analyst, high discount rates. Anecdote and analysis confirm it.”)

a result, the Nash equilibrium will result in increasing concentration, which is antithetical to the joint maximization solution.

Taking these insights at face value, a significant problem arises with respect to the Chicago approach. Defining the maximization of consumer welfare, as Chicago does, by price and output, surely a danger readily emerges where consumers face a collective action problem, or excessively discount the future state of the world, that an unattractive level of concentration will result? The Freiburg School would seem to think so and its provisions implicitly recognize that competition law can be employed to defeat the collective action problem above.

But this question is itself short-sighted, for if concentration of economic power in the hands of major corporations is viewed as a source of disutility for consumers, who would prefer access to family-owned and other small- and medium-sized businesses, then that prevalent dissatisfaction translates into a major source of competitive advantage for such businesses to enter the market once unwelcome concentration has taken place. This is the critical point. One would expect rapid entry to avail of such demand.

If a market structure fails to induce entry by small and medium-sized business once an “objectionable” and readily observable level of concentration has emerged, a strong argument can be made for rejecting the principles of the Freiburg School.

Importantly, with an unwelcome level of concentration having taken place, afflicted consumers would be expected to actively purchase from small firms entering the market. Excessive discounting of the future is no longer a problem once the future objectionable state of the world has actually arisen. In addition, interest groups could be created by consumer protection groups to help overcome the collective action problem. Moreover, small firms could enter through a joint venture, using a common brand or trade mark as a signaling effect to consumers of their small or familial status.

Thus, where no long-run entry is observed, the only explanation is that consumers are benefiting from the low-cost pricing and do not, in fact, desire less efficient, small business. Thus, a judicial or legislative rule providing a barrier to consumer welfare-enhancing actions by “dominant” and efficient firms looks not like a paternalistic protection of long-term consumer interests, but an authoritarian imposition of a political viewpoint not shared by society’s constituents – consumers. This insight gains a special force when one recognizes that majoritarian distaste of concentration is not required for small- and medium-sized business to gain a competitive foothold. Even 5% of consumers desiring the availability of family-owned enterprise provides a massive source of business for such a company contemplating entry into the market. One would expect limited entry, with 5% of consumers being supplied by small business, and the remaining 95% maximizing their utility by purchasing from the most efficient firms offering the lowest prices. An absence of even limited scale entry strongly indicates a complete lack of consumer demand for such family business and that consumers are in fact benefiting from the lower prices.

The strongest ground for rejecting the Freiburg School, however, relates to the rise of the so-called “new economy,” which is playing an increasingly central and important role in the global market. Such markets are often characterized by high fixed costs, economies of scale and, hence, falling average costs in production with the result that the markets lack a long-run competitive equilibrium.⁸⁵ Such network industries are often said to have “winner takes all” characteristics flowing from “tipping effects.” Enforcing ordoliberal ideology in the context of the new economy is apt to be disastrous. Imposing a multi-firm market structure on an industry whose underlying characteristics call for only one manufacturer creates a situation of massive inefficiency. Prices will be far higher than would be the case under unconstrained competition. Moreover, heavy administrative expenses would have to be incurred to maintain an artificial equilibrium in the market and these would constitute an additional loss.

In addition, the most meaningful form of competition with respect to the new economy may relate to innovation and standard setting.⁸⁶ Where “tipping effects” are especially strong, leading to consumer acceptance of a sole standard, monopolization may be almost inevitable. While the Freiburg School would not necessarily prohibit the existence of the monopoly, if its emergence could not be practically avoided, it would both require open

⁸⁵ See generally OZ SHY, *THE ECONOMICS OF NETWORK INDUSTRIES* (Cambridge University Press 2001).

⁸⁶ See, e.g., RICHARD POSNER *supra* note 2, at 248 (“The features of the new economy that I have been describing... tug it toward monopolization yet, oddly, toward competition. The paradox is dissolved by remembering that competition to obtain a monopoly is an important form of competition. The more protection from competition the firm that succeeds in obtaining a monopoly will enjoy, the more competition there will be to become that monopolist . . . this competition may be wholly desirable.”)

access to rivals and prohibit any practice creating a hindrance to free entry. Such requirements serve to reduce the reward earned by the successful innovator. As such potential innovators expend capital on their risky research and development on the basis of recoupment and reward through subsequent monopoly, ordoliberal principles would vastly truncate the ex ante expenditure on innovation, hence frustrating the emergence of new economy industries. It is clear that ordoliberal policies are incompatible with the competitive processes of the new economy. The consideration of the Commission's proposed remedy with respect to Microsoft below makes clear the damage likely to flow from the Europeans' treatment of exclusionary practices in this novel context.

Interestingly, however, the conclusion that the Freiburg School's influence should be filtered from EC competition law is not as straightforward as one would initially imagine, given the force of the above concerns. Before concluding that a rejection of ordoliberal jurisprudence within EC competition law should take place, a number of arguments for continuing adherence to Freiburg shall be considered.

First, it is worth considering a possible economic base for the Freiburg School whereby even an approach to antitrust in pursuit of maximization of consumer welfare may find increasing concentration on grounds of efficiency objectionable.

From an economic perspective, the Freiburg School's insight is most compelling in the case of a firm whose efficiency in production enables it to achieve a monopoly, but where the efficiency thus generated is outweighed by the social loss of the ensuing

supracompetitive pricing. Assuming that no company is in a position by which to enter and challenge this monopoly, due, for example, to the perceived likelihood of predatory price-cutting behavior on the part of the incumbent,⁸⁷ it may be that consumer welfare would be maximized in the long run by employing competition law to prevent the company attaining a monopolistic position in the first place. For this to be the case, the constraining influence created by less efficient, incumbent competition on the price elasticity of demand facing the efficient firm must be greater than that which would be created by the threat of entry to the efficient firm were it allowed to attain a monopoly.

However, not only is there reason to be skeptical about the realism of such an outcome, but the recognition of such a principle is apt to be extremely dangerous. This is particularly so with respect to the incentive to compete aggressively on price, to innovate and to engage in research and development. In short, recognition of such a principle would blunt the fundamental process of competition. Rivalry between undertakings for customers' business leads to price-cutting, cost-reduction through increased efficiency and innovation with the ultimate goal of increasing market share and profitability. The imposition of a constraint on further growth by competition law would prevent further desirable instances of this sort of competition. Moreover, it is apt to be prohibitively difficult to accurately identify the point at which to employ the law to curtail the further

⁸⁷ Though not, interestingly, due to the fact that the entrant's price would be above the incumbent's monopoly price, for in that case the entrant's inefficiency is of such an extent as to render that company's existence an irrelevant factor in the incumbent's first order condition for profit maximization. If such were the case, the fact of the incumbent's uncontested monopoly is an unequivocally desirable outcome.

growth in market share of an efficient company. It is likely that a large number of Type I errors would result.⁸⁸

The second obstacle to striking Freiburg principles from EC law lies in the following observation: the recent enlargement of the European Union to incorporate ten additional Member States, of which seven – the Czech Republic, Slovakia, Estonia, Latvia, Lithuania, Hungary and Slovenia – had Communist or Socialist regimes during the Cold War period, provides an economic situation more akin to the context in which the Freiburg School arose than would the modern economies of the western European countries and the United States. As a result, ordoliberal thinking may still have a role to play with respect to these economically developing countries. The relevant issue is which jurisprudential foundation of competition law – allocative efficiency or ordoliberalism – would be expected to most effectively aid in these countries' economic development. Given the overwhelming economic support for free trade through comparative – as opposed to absolute – advantage,⁸⁹ a strong case can be made that a competition policy focusing on allocative efficiency, which would facilitate a country's maximization of comparative advantage by minimizing domestic costs of production, would be best placed to enable these developing Member States to successfully integrate with the European Union.

⁸⁸ In other words, many situations would arise where an efficient firm increasing market share to the benefit of consumer-welfare would nevertheless be mistakenly deemed objectionable.

⁸⁹ See, e.g., GIANCARLO GANDOLFO, *INTERNATIONAL TRADE THEORY AND POLICY*, (Springer 1998); NIGEL GIRMWADE, *INTERNATIONAL TRADE POLICY: A CONTEMPORARY ANALYSIS*, (Routledge 1996).

Third, and as was considered above, a unique and fundamentally important characteristic of EC competition law is the overriding priority given single market integration. The case can reasonably be made that ordoliberal thought, with its emphasis on keeping access to markets open and unhindered provides an ideal foundation upon which to base a competition policy that seeks to guarantee transparency between its Member States' borders. The United States simply does not share such a goal in employing its antitrust regime and, if some divergence in international competition policy emerges, perhaps it is simply unavoidable. Critical to resolution of this issue will be the predicted effect on single market integration of a competition regime dedicated solely to achieving allocative efficiency and consumer welfare maximization.

Perhaps, some would argue that the ideal outcome is for the EC and the U.S. to adopt an amalgam of the Chicago and Freiburg Schools, in which the gains of allocative efficiency are recognized, but subject to the limit that excessive concentration may represent a social evil over the long-run, short-run efficiencies notwithstanding. This would involve the United States, as opposed to the European Community, altering its antitrust policy, perhaps in a manner more reflective of ordoliberal thinking. This suggestion is by no means unprecedented.⁹⁰ This is due to the fact that European competition law currently represents such an amalgam, with neither the Freiburg nor Chicago School influences enjoying unqualified application, rather each being applied in proportion to the other.

Yet, while such an approach has some theoretical backing within the European Union, given the single market integration imperative, it is not at all clear why such an approach

⁹⁰ See, e.g., Robert Pitofsky, *supra* note 2.

would be optimal within the United States. Moreover, and as was outlined above, the market integration principle is by no means diametrically opposed to the pursuit of economic efficiency. It follows that ordoliberal thinking can be jettisoned in light of modern economic thought and an antitrust policy in pursuit of consumer wealth adopted, qualified only by those instances where efficiency-enhancing practices would nevertheless create a long-run obstacle to the single market.

It is submitted that an economic approach to competition policy, as a modified variant of the Chicago School theory, is not only the best route by which to maximize consumer welfare, but, critically, is also generally consistent with the single market imperative that underlies the jurisprudence of the EC generally.

In order to gain an appreciation of how ordoliberal thought pervades European antitrust, it is best to compendiously survey a number of branches of the law. Adopting the fundamental teaching of the Chicago School that consumer welfare is to be furthered by lower prices and higher output as the optimal standard, we can therefore proceed to identify representative areas of divergence. In so doing, it must be recalled that the ultimate goal from this paper's perspective is to achieve the greatest possible allocative, distributive and productive efficiency and, *ceteris paribus*, the most effective way to attain this goal is to promote the process of vigorous competition so as to avoid cases of monopoly. It will be concurrently shown how the law covering these areas can be amended in a manner reflective of the principles outlined above and how such amendment will be to the benefit of consumers and the economy as a whole.

- *Identifying and Challenging the Freiburg School in EC Competition Law*

It is unquestionable that the message of the Freiburg School can still be seen pervading EC competition law, particularly with respect to the scrutiny given the requirement of fairness on the part of dominant firms' behavior and the hostility with which any exclusionary actions are viewed, irrespective of the efficiency underlying such conduct.

In particular, the "as if" aspect of ordoliberal competition policy, which requires monopolists to behave "as if" they faced competition,⁹¹ features heavily in the European Court of Justice's rulings with respect to the concept of "abuse of dominant position." The fact of dominance itself is not prohibited. Divestiture is not sought. Instead, and in contrast to the approach typically adopted in the United States, firms classified as dominant face equitable constraints on their behavior, being subjected to a "special responsibility" not to behave unfairly,⁹² even where consumer welfare is not threatened.⁹³

In effect, such firms are required to behave "as if" they were not dominant. Yet, the European definition of fairness goes even further by prohibiting dominant firms from

⁹¹ David Gerber, *supra* note 58.

⁹² Case 322/81, *Michelin v. Commission*, 1983 E.C.R. 3461, [1985] 1 C.M.L.R. 282, para 57 ("[a dominant firm] has a special responsibility not to allow its conduct to impair undistorted competition on the common market.")

⁹³ *See, e.g.*, David J. Gerber, *supra* note 16 ("while the prohibition of cartel agreements had analogues in U.S. antitrust law, the concept of prohibiting abuse of a market-dominating position was an important new development closely associated with ordoliberal and German competition law thought, and very different from U.S. concepts... Moreover, this influence is often evident in the development of the law by the European Commission and the European Court of Justice, for concepts developed in German competition law frequently find their way into the competition law of the Community.")

performing acts that non-dominant firms are free to do. The result may be thought of as the effective imposition of a penalty upon a firm whose success leads it to dominance.⁹⁴ A particularly pertinent example of this involves Article 82 (2)(a) EC's prohibition of abusively high pricing.⁹⁵ American law has no similar provision. But, given the importance of the schism possibly at issue, it is important to make explicit a number of the major characteristics of EC law that can plausibly be explained by ordoliberal thinking and to demonstrate how the introduction of an economic approach would lead to superior outcomes. To do so, three unilateral business practices indicative of the European incorporation of ordoliberal thinking will be compendiously considered.

1) Predatory Pricing

The process by which a dominant firm forces competitors from a market through “unfairly” low pricing encapsulates quite succinctly the various socio-economic objections of the Freiburg School, in addition to the political hostility toward large corporations whose pricing eliminates small- and medium-sized, often family-owned, business. It was argued above that these concerns are no longer appropriate within the modern European market.

⁹⁴ See, e.g., RICHARD WHISH, *supra* note 8, at 175 (“A criticism of the Commission has been that it prohibits business practices of dominant firms that would be perfectly acceptable if the firm were not dominant and yet which are considered to be abusive if they are dominant; this amounts to the imposition of a handicap upon those firms, effectively penalizing them because of their success.”)

⁹⁵ See, e.g., Commission Press Release IP/98/707, 27 July 1998 (pertaining to the Commission's investigation of excessive pricing with respect to cell phone calls.)

The European Court of Justice has viewed low pricing leading to increasing concentration with hostility.⁹⁶ Strong evidence of this exists. First, the fact of harm to business is sufficient. A plaintiff need not prove any long-run detriment to consumer wealth in the form of likely higher prices in future periods under EC competition law.⁹⁷

Second, a plaintiff need not prove that the dominant firm's pricing was so low as to be inconsistent with its short-run profit maximization. Rather, evidence of a dominant firm's pricing below average total cost (ATC), though above average variable cost (AVC), coupled with intent to eliminate a competitor, will constitute a violation of Article 82 EC.⁹⁸ Economics teaches us that a firm should continue to operate at optimum capacity and, in cases of low demand, should price anywhere above AVC in the short-run. In other words, rational, short-run profit maximizing behavior on the part of a business may be deemed "predatory" under EC law. This is inconsistent with the fundamental tenet of the offense, namely that a predatory firm must necessarily forego profitability in a particular period in order to make greater profits in the future. A firm being free to act in a manner consistent with its immediate, first order condition for profit maximization is central to the workings of a free economy. Yet, if such low pricing leads to objectionable concentration, ordoliberal concerns are nevertheless raised.

⁹⁶ See Case C-62/86, *AKZO v. Commission*, 1991 E.C.R. I-3359, [1993] 5 C.M.L.R. 215.

⁹⁷ *Id.* at para 71 (acknowledging the principle of recoupment, but declining to regard it as a requirement.)

⁹⁸ *Id.* (pricing below ATC, yet above AVC can still be a violation of Article 82 when coupled with a desire to eliminate a competitor. The problem arises when conscious pricing within this range, even though profit-maximizing, may be made with knowledge that less efficient rivals will be forced from the market.) See also Case C-395/96, *Compagnie Maritime Belge v. Commission*, 2000 E.C.R. I-1365, [2000] 4 C.M.L.R. 1076. (Selective price cutting, even if not below cost, may be objectionable and illegal under Article 82 EC.)

Nonetheless, it was stressed above, in rejecting the notion that consumers cannot act in their own interests, that a lack of entry into a market by small business charging higher prices in the presence of a low pricing corporation strongly implies that consumers are benefiting from the latter's presence. Thus, under no circumstances should such low pricing, even below cost pricing, be prohibited where the low-pricing firm does not obtain monopoly power as a result. In essence, low pricing in a single period to the benefit of consumers, as evidenced by their purchases from the "predatory" firm, is unobjectionable if supracompetitive prices cannot be charged later.

Consistent with this reasoning, the U.S. Supreme Court has required proof of a "dangerous probability of recoupment" in predatory pricing claims.⁹⁹ The Chicago approach to antitrust counsels lower prices and higher output as the key to higher consumer welfare. In this sense, therefore, competition authorities should be slow to place any barriers in the path of vigorous price competition. Recognizing that below-cost pricing is to the unequivocal short-run benefit of consumers, American courts require proof of likely future harm thereto. If no danger of such harm is apparent, for example because barriers to entry to the market in question are slight, U.S. law declines to prohibit the practice, recognizing instead that the entire episode resulted in heightened consumer wealth, harm to incumbent competitors notwithstanding. Moreover, the requirement of likely future harm serves to reduce the probability of erroneous judicial determination.

⁹⁹ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (concluding that no violation of Section 2 of the Sherman Act could follow from a firm's below cost pricing, where the oligopolistic nature of the market rendered the probability of recoupment unlikely.)

This clear divergence in substantive law directly reflects the adherence to differing schools of thought – Chicago versus the amalgam of theoretical bases in Europe. The policies and conclusions discussed heretofore counsel an amendment in this area of European law.

2) *Product Tying*

Perhaps the most economically complex unilateral business practice relates to a firm's imposition of a tie-in. Product tying can be usefully employed as a framework in which to apply the advocated economic approach and to discard the ordoliberal philosophy still underlying EC competition law. The two approaches – Freiburg and Chicago – are diametrically opposed in this context and, in addition, adherence to ordoliberal views within the context of product tying is likely to be heavily inimical to consumer welfare. Coupled with the observation that the major instances of international divergence have arisen in the context of tie-ins,¹⁰⁰ the need to address the subject becomes compelling.

For the purposes of the following discussion, the extreme assumptions shall be made that:

(1) the tying firm has a complete monopoly over the tying market, (2) prior to the tie, the tied market was subject to perfect competition, with price equal to the marginal cost of production, and (3) the only consumers of tied products are those who also consume the

¹⁰⁰ Compare U.S. Dep't of Justice Press Release, Justice Department Requires Divestitures General Electric and Honeywell (May 2, 2001), at http://www.usdoj.gov/atr/public/press_releases/2001/8140.htm, with *General Electric/COMP/M.2220*, EC Decision of July 3, 2001, at http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf.

corresponding tying products and derive a higher degree of utility from the latter. Only in such rare circumstances will a tying firm be able to acquire monopoly market share of the tied market so that genuine ordoliberal issues will be raised. It will therefore be assumed that the imposition of a tie confers a monopoly market share on the tying firm in the tied market, which was formerly subject to perfect competition.

The tension between the Freiburg and Chicago Schools is particularly acute because market share acquired through product tying, though elevating concentration, is highly unlikely to confer market power on the tying firm, save where the tying and tied goods are complementary.¹⁰¹

A tying firm will necessarily be unable to charge a double monopoly mark-up.¹⁰²

Assuming that it is already charging a monopoly price in the tying market, should it attempt to tie a second good at a supracompetitive price it will effectively elevate its price in the tying market to beyond the profit-maximizing level. If such ties cannot reduce consumer welfare, why are they imposed? The answer, almost certainly, is due to the efficiencies underlying tying arrangements.¹⁰³

Nevertheless, care should be taken with respect to the double monopoly mark-up constraint in the context of complementary goods. If a tying firm has market power in the tying market, does it make a difference whether such power is exercised in the tied as opposed to tying market?

¹⁰¹ Ward S. Bowman, *Tying Arrangements and the Leverage Problem*, 69 YALE L.J. 19 (1957).

¹⁰² *Id.*

¹⁰³ See e.g., CARLTON & PERLOFF, *supra* note 29 at 319.

Not if the tying firm engages in bundling. Where a firm engages in fixed proportions tying, it will be incapable of diminishing consumer welfare – as goods are bundled, if consumers in the tied market are made worse off by a tie, the consumers in the tying market necessarily benefit to a commensurate degree and vice versa. Fixed proportions bundling cannot, therefore, raise consumer welfare issues absent extraordinary circumstances.¹⁰⁴

Variable proportions requirements contracts, however, present a more complicated situation in which tying may reduce consumer welfare in one market by more than it increases such welfare in the other market.¹⁰⁵ As the tying market is already monopolized and, by assumption, a monopoly price was being charged prior to the introduction of the tie, the tying firm will maximize profit by reducing that monopoly price in the tying market to avail of the demand-elevating effects created thereby in the tied market. Simultaneously, the tying firm will increase the price in the tied market to increase its profits. This is because zero economic profits were being enjoyed there due to the fact that price equaled marginal cost before the tie.¹⁰⁶ As a result, prices in both the tying and tied markets will be somewhere between the competitive and monopoly prices; consumers will be better off in the tying market and worse off in the tied market. Which effect is greater?

¹⁰⁴ These may include instances in which the tying firm is subject to price regulation in the tying market or where the tying market is a high-technology market, subject to powerful network effects, in which case bundling could conceivably be used to further consumer “lock-in” and to thereby disrupt future competition with respect to standard setting.

¹⁰⁵ See, e.g., Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 Colum. L. Rev. 515 (1985).

¹⁰⁶ This is due to the assumption of perfect competition in the tied market prior to the tie.

The answer necessarily depends on the underlying relation between the market demand curves in the tying and tied markets and is therefore somewhat ambiguous. Nevertheless, given the underlying assumption that the consumers of the tying product derive greater utility therefrom than they do from the tied product, it is more likely than not that a reduction in the price of the tying product will increase consumer welfare by more than a rise in the price of the tied product will reduce it.

Even where complementary goods are involved, therefore, overall consumer welfare is likely to rise, even if market power is exercised over two markets.¹⁰⁷

Thus, a court adopting a consumer welfare standard – economically defined – would generally approve such tying arrangements for contributing to efficiency and consumer wealth. In contrast, a Freiburg court would find a quintessential violation of competition law in the circumstances due to the concentration and reduction in consumer choice involved. Moreover, a barriers to entry theory would likely be adopted in that potential entrants to the tied market would be unable to directly access consumers, having to enter both the tying and tied markets together,¹⁰⁸ which of course violates a major ordoliberal goal. From an economic perspective, however, this issue is moot because allocative efficiency only desires entry by a rival equally or more efficient than the incumbent. A

¹⁰⁷ CARLTON & PERLOFF, *supra* note 29 at 638.

¹⁰⁸ *See, e.g.*, JOE S. BAIN, *BARRIERS TO NEW COMPETITION* (Cambridge, MA: Harvard University Press 1956). *But compare* GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 67 (1968) (arguing that a long-run barrier to entry is one that imposes a cost on an entrant that an incumbent does not need to bear).

basic insight, based on Coasian economics,¹⁰⁹ is that a more efficient entrant will not be barred from the tied market: he will merely contract with the incumbent who will outsource production, thereby increasing profits, while the efficiency saving in production will be passed onto the consumers in the form of lower prices. Moreover, should he wish to sell directly to consumers, he can enter both the tying and tied markets simultaneously. As capital markets generally work efficiently, access to the requisite capital to enter on such a large scale would only be frustrated were there a high risk of a post-entry insolvency-producing equilibrium resulting.¹¹⁰ Given that the incumbent is enjoying monopoly profits, post-entry insolvency is highly unlikely¹¹¹ and, thus, access to capital will not constitute a barrier to entry.

Europe has unsurprisingly fallen on the ordoliberal side of the line. Where a dominant firm imposes a tie, a violation of Article 82 EC automatically follows.¹¹²

¹⁰⁹ See Ronald Coase, *The Nature of the Firm*, *ECONOMICA* (1937), at http://people.bu.edu/vaguire/courses/bu332/nature_firm.pdf (arguing that firms will vertically integrate only where “the cost of using the price mechanism” – that is, contracting with third parties, exceeds the cost of in-house production).

¹¹⁰ Such a scenario may arise if price-based competition à la Bertrand would be expected post-entry in the presence of fixed costs. The ensuing marginal cost pricing will lead to insolvency for the entrant, but not for the incumbent assuming the latter has recovered its fixed costs through supracompetitive pricing pre-entry. If there is a perceived risk of Bertrand competition following entry, the cost of capital will be rendered high for the entrant due to risk. Alternatively, the incumbent, if it is more efficient, may employ a limit price strategy. The effect will be the same.

¹¹¹ It should be noted that the Nash equilibrium is for the incumbent to accommodate entry and share the market. This renders the chance of an insolvency-producing equilibrium with price at or below the entrant’s marginal cost highly unlikely.

¹¹² See, e.g., Case T-30/89, *Hilti AG v. Commission* 1990 E.C.R. II-163, 4 C.M.L.R. 16 (1992), upheld on appeal Case 53/92 P *Hilti AG v. Commission* 1994 E.C.R. I-667, 4 C.M.L.R. 614 (1994); 1992 O.J. (L 72) 1, 4 C.M.L.R. 551 (1992), upheld on appeal to the CFI Case T-83/91, *Tetra Pak International SA v. Commission* (1994) E.C.R. II-755, (1997) 4 C.M.L.R. 726 and on appeal to the ECJ case C-333/94 P *Tetra Pak International SA v. Commission* 1996 E.C.R. I-5951, 4 C.M.L.R. 662 (1997); 1988 O.J. (L 284) 41, 4 C.M.L.R. 196 (1990).

Intriguingly, however, the United States does not represent a shining beacon of perfection with regard to the employment of economically-informed antitrust principles within the field of tying practices. It is amusing to note that some of the most scathing and derisive criticism emanating from America toward Europe has been made in the context of tying law – a field where the U.S. has quite similarly failed to employ price theory correctly and which has thereby created a situation open to the identical criticism that it serves to protect competitors from more efficient rivals. Indeed, historically at the time of the Warren Court, the United States would have been more prone to that same criticism than Europe has ever been.¹¹³

Nevertheless, there is evidence of U.S. law’s potential move away from the standard of per se illegality. First, the Supreme Court has come close, 4-5, to reversing that standard.¹¹⁴ While the Court has not taken the opportunity to make this dissenting opinion binding law in subsequent cases,¹¹⁵ it at least demonstrates that the leverage and foreclosure theories of tying do not enjoy ubiquitous support within the highest levels of American jurisprudence.¹¹⁶ It suggests too that as the economic approach to antitrust becomes further engrained, the Court may indeed abandon its traditional position.

¹¹³ At this time, the Supreme Court went so far as to dispense with the requirement of significant market power with respect to the tying firm. *Northern Pacific Railway Co. v. United States*, 365 U.S. 1. As will be discussed in Chapters Three and Four, an accurate finding of market power is an absolute sine qua non for even a possibility of anticompetitive effect ensuing. U.S. law now correctly requires a showing of “substantial market power.” *See, e.g., Hardy v. City Optical Inc.*, 39 F.3d 765, 767 (7th Cir. 1994).

¹¹⁴ *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 1 (1984).

¹¹⁵ *See, e.g., Eastman Kodak v. Image Technical Services, Inc.*, 112 S.Ct 2072 (1992).

¹¹⁶ It should be noted that it is impossible to make such an observation with respect to the European Court of Justice, as it does not issue dissenting opinions.

Second, a modern move in American law away from per se illegality exists with respect to physical integration. Where two goods are physically integrated, which, as an economic matter, is analogous to a bundle, the law is dramatically different. Here, legality is effectively presumed and only where a showing that the integration serves no consumer purpose will illegality follow.¹¹⁷

Third, a clear move away from the traditional position has arisen with regard to the new economy. The *Microsoft* case saw the D.C. Circuit enunciate a rule of reason approach to product tying in the context of high-technology, software markets.¹¹⁸

Finally, when one considers that U.S. law has adopted an economic approach to most other areas of antitrust law and that such an approach is therefore likely to eventually permeate through to tying arrangements, it seems reasonable to observe that a gulf exists, and is likely to grow considerably larger, between the U.S. and EC treatment of tie-ins. As a result, the economic approach advocated heretofore would serve to bring U.S. law to the destination to which it is already gravitating, whilst simultaneously achieving international harmonization within this area of law.\

3) *Refusal to Supply*

¹¹⁷ *Response of Carolina, Inc. v. Leasco Response, Inc.*, 537 F.2d 1307, 1330 (5th Cir. 1976) (the antitrust laws are violated only where the integration “has been for the purpose of tying the products, rather than to achieve some technologically beneficial result.”)

¹¹⁸ *United States v. Microsoft Corp.*, 147 F. 3d 935, 949-50 (D.C. Cir. 1998).

The need to jettison ordoliberal principles from European law can be well illustrated by an examination of the EC's treatment of mandatory access. Unsurprisingly, the entire concept of refusal to supply can be seen to mirror the Freiburg School, which seeks to prohibit any actions, concerted or otherwise, that may create obstacles to a rival firm or consumer accessing a market. It is well settled under EC law that a dominant firm cannot unilaterally decide to cease supplies to downstream companies where the dominant undertaking.¹¹⁹ Indeed, the concept of mandatory access has been taken so far under European law that it has even been applied in a compulsory dealing context – very much akin to copyright law.¹²⁰

The danger inherent in compelling open access remedies a la Freiburg can be made most clear through an illustrative model. A pertinent and topical example can be employed in relation to the recent action against Microsoft for product tying.

Adopting the goals of free access to markets and preservation of consumer choice, the Commission implemented a remedy requiring Microsoft to disclose the interfaces necessary to enable rivals to achieve interoperability with the Windows operating system.¹²¹ The quasi-open source remedy sought by the Commission is controversial. One may initially take the view that by compelling the emergence of interoperability, the Commission will unequivocally increase the level of competition within the market. But this view is necessarily correct only if one views the market in a static context. By

¹¹⁹ Cases 6/73 & 7/73, *Commercial Solvents v. Commission*, 1974 E.C.R. 223, [1974] 1 C.M.L.R. 309.

¹²⁰ *See, e.g.*, 1991 E.C.R. II-485, [1991] 4 C.M.L.R. 586, upheld by the ECJ Cases 241/91, *RTE & ITP v. Commission*, 1995 E.C.R. I-743, [1995] 4 C.M.L.R. 718.

¹²¹ *Id.*

attempting to improve ex post access to the relevant market, the Commission may, ironically, cause substantial long-term harm.

This point can be made explicit through game theory. The assumptions made for the purposes of the model are, by design, extreme, so as to make evident the potential harm ensuing from the Commission's remedy.

The validity of former Competition Commissioner Mario Monti's belief that the remedy imposed "restores the conditions for fair competition in the markets concerned"¹²² depends critically on the fundamental, and readily questionable, assumption that, by the time of effective monopolization of Windows operating software, Microsoft will have been adequately compensated through its pre-judgment enforcement of proprietary rights and post-"dilution" income.¹²³ The critical issue pertains to proper incentive creation. Ex post evidence of sufficient compensation makes a good case for allowing free access, except of course for the consequent effect on further potential innovation. More clear is the likely effect on would-be developers of platform standards, in the form of on ex ante incentives, under a regime where success guarantees disenfranchisement of proprietary rights. An application of basic game theory may help to make this clear.

In a one-shot game, where, for the sake of simplicity, two rivals, Alpha and Beta, are in the process of developing competing standards, the dominant strategy will be for both

¹²² *Id.*

¹²³ The term "dilution" is not used as a state of art as it appears within the law of copyright. Instead, it refers here to the reduced income likely to flow to a monopolist following the imposition of an open source/free access remedy.

competitors to seek to monopolize the market to maximize their single-period pay-off where the expected value of intense innovation ($\Pi_H/2$) is greater than the profit from engaging in only a minimal level of innovation (Π_M). The Nash equilibrium will be at the socially optimal level with each company dedicating a high level of capital. It is assumed that the market is one characterized by “tipping phenomenon” after a sufficiently high level of innovation:

		Beta	
		<u>$K_B = \text{low}$</u>	<u>$K_B = \text{high}$</u>
Alpha	<u>$K_A = \text{low}$</u>	Π_M, Π_M	$0, \Pi_H$
	<u>$K_A = \text{high}$</u>	$\Pi_H, 0$	$\Pi_H/2, \Pi_H/2.$

Where K = capital invested; Π_H = high level of profit; Π_M = a moderate level of profit consistent with a Cournot-Nash equilibrium in a duopoly; and $\Pi_H/2 = 50/50$ chance between a high level of profit and zero profit (exit).

In a multi-period world without a determined end, however, the resulting incentives may be rendered perverse by implementation of the Commission’s remedy. Both competitors know ex ante that their rewards will drop to zero if either’s platform becomes the universal standard for the market in question.¹²⁴ This fact markedly reduces their incentive to engage in the kind of intense innovation that is likely to lead to monopolization. Instead, both parties know that their best strategy may be to produce platforms of a more homogeneous quality with neither seeking to innovate with the level of enthusiasm, or, indeed, through the dedication of sufficient capital, to produce platforms of the quality available in a “first-best” world.

Given the single-period payoff matrix, Alpha and Beta will engage in intense innovation ($K_A = K_B = \text{high}$) only if:

$$\Pi_{N \rightarrow \infty} (K=\text{high}) > \Pi_N (K=\text{low}) + \frac{\Pi_{N+1}}{(1+i)^1} + \frac{\Pi_{N+2}}{(1+i)^2} + \frac{\Pi_{N+3}}{(1+i)^3} + \frac{\Pi_{N+4}}{(1+i)^4} + \dots + \frac{\Pi_{N \rightarrow \infty}}{(1+i)^{N \rightarrow \infty}}$$

Assuming constant discount rate and profit levels, the socially desirable level of innovation will materialize only if:

¹²⁴ This, of course, is an unrealistic assumption, for the winner will continue to reap financial reward from its innovation. Nevertheless, any kind of compulsory access reduces the expected return from innovation and, hence, blunts the incentive to engage in research and development ex ante. The potential consequences of an open access remedy can be made most clear, however, through the adoption of extreme assumptions.

$$\frac{\Pi_H}{2} > \frac{\Pi_M}{i}$$

Waldman & Jensen estimate most firms' real-life discount rates as typically being between 0.05 and 0.1.¹²⁵ Taking it as 0.05, then the socially outcome will arise only if:

$$\Pi_H > 40 \Pi_M$$

That is, only if the single-period profit from successfully monopolizing the market is at least forty times higher than the single-period profit from engaging in little innovation will the desirable level of investment occur. This may or may not be the case, but there is certainly no reason to assume that the level of profits earned will be sufficient as to have spurred the innovation.

Clearly this fear could be allayed somewhat by arguing that in marginal cases competition policy should still err on the proprietary side of the line, but it surely remains the case that it is the duty of any responsible antitrust policy to further investigate the likely effect on incentive-creation by the proposed approach.

Of course, the European Commission would no doubt argue that only where the desired level of investment has *in fact* occurred should an open access regime in the form of compulsory interoperability be implemented. But the point of the above exercise is to

¹²⁵ WALDMAN & JENSEN, *supra* note 31.

show that, by implementing such a policy once, regulators cannot *credibly* commit to not doing so again, with the resulting effects on incentives outlined above.

Insofar as the Commission decision stands for the precedent that winners within new economy industries will have their reward curtailed through the imposition of interoperability remedies, it creates a significant danger of in fact reducing the level of the important form of competition in “winner takes all” markets. As was argued above, the truly meaningful and desirable form of competition with respect to the new economy may well take place in research and development to establish standards. Post-success monopoly profits, while in static context a clear source of disutility to consumers, is a necessary condition for pre-establishment competition to take place. There is reason to believe the post-success monopoly pricing will be ephemeral if a socially-desirable form of research and development by the incumbent monopolist does not take place, for it will quickly be displaced.¹²⁶ The prohibition of practices likely to prevent that displacement on grounds other than efficiency should be pursued especially vigorously in this context, but it was readily shown that the product tying taking place with respect to Microsoft probably did not have such an objectionable effect.

It may be concluded that the Microsoft litigation provides both a source of hope with respect to U.S. development in product tying law, with a more flexible rule of reason

¹²⁶ See, e.g., RICHARD POSNER *supra* note 2, at 249-250 (“The gale of creative destruction that Schumpeter described, in which a sequence of temporary monopolies operates to maximize innovation that confers social benefits far in excess of the social costs of the short-lived monopoly prices that the process also gives rise to, may be the reality of the new economy. This is especially likely because quality competition tends to dominate price competition in the software industry.”)

approach being adopted, and a reason for despair with regard to Europe. It is clear that ordoliberal policies remain as firmly engrained as ever. Litigation in the context of the new economy could have provided the perfect setting for a review of the European approach and it is most disappointing that it did not take place.

- *Conclusion*

Europe is now faced with difficult choices with respect to the future direction of its evolving competition regime. While the Chicago School and post-Chicago literature have fused in the United States to ensure a central role for microeconomics, game theory and empiricism, no similar foundational principle is readily observable underlying EC competition law. The dangers associated with this are numerous. First is the danger to legal certainty within Europe itself. The current body of European antitrust law reflects a number of philosophical approaches to competition policy which are not readily reconcilable and which, in many circumstances, are inherently contradictory. EC competition law thus finds itself in an uneasy resting place, precariously balancing the often diametrically opposed socio-economic philosophies of consumer wealth, market integration, equity and ordoliberalism. A schism between practice and theory creates an imbalance and this imbalance, if not addressed, may eventually become perilous.

Second, and most importantly, achieving effective antitrust harmonization has never been so vital as it is in the context of the increasing globalization of markets. Great steps have been, and continue to be, made in this regard, which should be applauded. Nevertheless, pure harmonization will forever remain elusive so long as fundamental and unequivocal standards by which to inform competition policy fail to emerge on both sides of the Atlantic.

The analysis advocated by this paper finds attractive and relatively straight forward resolution when employed through the lens of modern economics with the goal of maximizing consumer welfare. The employment of price theory as a means by which to maximize consumer wealth carries a concomitant plethora of beneficial effects, including the increasing international competitiveness of European industry, the lowering of inflation and facilitates a most fundamental form of democratic expression: enabling the public at large to decide the ultimate success or failure of businesses catering thereto. There is a strong argument that the grounds calling for the paternal state no longer exist, or exist to such a truncated degree as to no longer be worthy of antitrust concern.

It is understandable that the unwavering, pro-consumer principles advocated heretofore may sit uncomfortably with some observers. Even putting aside the counter-intuitive nature of some aspects of industrial organization, it may be difficult for some to accept the premise that an unchallenged rise in concentration on the basis of efficiency within European markets will be to the ultimate benefit of all involved, given the European history of such market structures. Yet, it is submitted that forceful, critical and directed

insight into the economics of the situation will reveal, not a draconian and right-wing amalgamation of legal principles but, a well reasoned, perspicacious and ultimately welfare-enhancing legal framework to launch the European Union into the 21st century as one of the world's greatest, and most competitive, economic powers.

Competition policy setters in Europe are now faced with, what may be fairly characterized as, an exigency in deciding whether to increase the level of critical, economic insight into the doctrines pervading the law. It is indeed true that the "European Union is at a crossroads as to whether it will move to the dominant U.S. paradigm."¹²⁷

The sooner Europe moves toward adopting economics as the sole guide to dictating antitrust policy, the better off the consumers and the economies of the Member States of the European Union will be. Unqualified antitrust harmonization with respect to the United States awaits such an evolution. While the obstacles to achieving this goal are immense, it is the optimistic belief of the author that such change is possible. To quote the recent, encouraging aspirations of the current European Competition Commissioner:

"I think that competition policy evolves as our understanding of economics evolves. In days gone by, "fairness" played a prominent role in [U.S.] enforcement in a way that is no longer the case. I don't see why a similar development could not take place in Europe."¹²⁸

¹²⁷ Eleanor M. Fox, What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect, at <http://www.antitrustinstitute.org/recent2/228.pdf>.

¹²⁸ Neelie Kroes, *supra* note 24.

Statement of Originality:

The foregoing piece has been inspired through research for my Ph.D degree, which is in its terminal stages. I have read widely on the topic in question and can confidently state that the above Note is original. While much academic comment exists on the nature and evolution of U.S. antitrust law, American treatment of both European competition policy and the source of transatlantic divergence is rather sparse. This is especially true with respect to the Freiburg School of ordoliberalism. David Gerber, cited above in the Note, is one of very few authors to have explored the background of that school in detail. Nevertheless, no substantive critique of the role of Freiburg within Europe has been furthered within the U.S. literature, either in isolation or in the transatlantic context portrayed above.