UNITED STATES OF AMERICA

Federal Trade Commission

WE NEED TO TALK: TOWARD A SERIOUS CONVERSATION ABOUT BREAKUPS

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Introduction

Thank you, Harold, for that introduction. And thanks to the Hudson Institute for hosting us this afternoon. It's an honor to join the substantive policy conversation that Hudson fostered for more than half a century, and to contribute to the important work Harold is doing here at the Center for the Economics of the Internet. The fact that terms like "network effects" and "creative destruction" are the subject of frequent punditry testifies to the timeliness of the work you do.

Before I go further, the necessary caveat: The views I will express are my own and do not necessarily reflect those of the Commission or of any other Commissioner.

The populism enthralling the Left *and* Right in American politics today is bringing renewed focus to antitrust law and policy. Some of the concerns that underlie this renewed focus may be real: scholars point to indicia of increasing

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concentration in industry;[1] economic gains are not always shared broadly;[2] and those gains often come from growth that disrupts businesses and jobs alike.[3] There is nothing wrong with taking a look at the state of law and policy and, like Chesterton's Fence, asking why it is where it is.[4] But there is everything wrong with pushing dramatic changes to either without due consideration of the answer.

These days, quite a few editorial and opinion pages choose histrionics over the history we should consider, sounding alarms about antitrust and its alleged responsibility for the rise of fascism[5], or feudalism[6], or a new "Gilded Age"[7]—any historical metaphor will, apparently, do. American corporations, we are told, represent a clear and present danger to American capitalism and democracy…less concern, meanwhile, about those openly and notoriously advocating for socialism.

Such is our discourse, as politicians and pundits alike call for the breakup of American corporations, too often without giving serious consideration to what

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[1] For a careful review of this claim, see Carl Shapiro, Antitrust in a Time of Populism, 61 INT'L J. INDUS. ORG. 714, 721 (2018).

[2] *See*, *e.g.*, research by Raj Chetty and co-authors at Opportunity Insights, https://opportunityinsights.org/paper/.

[3] *See*, *e.g.*, David Autor, *Work of the Past, Work of the Future*, AM. ECON. ASS'N: PAPERS & PROC. (forthcoming May 2019), https://economics.mit.edu/files/16724.

[4] GILBERT KEITH CHESTERTON, THE THING: WHY I AM A CATHOLIC (1921). There is often a good reason why the fence is where it is. I address some of the concerns that led modern antitrust law and policy to replace the *ancien régime* in my speech, "Post Hoc, Ergo Propter Hoc". Noah Joshua Phillips, Commissioner, U.S. Fed. Trade Comm'n, Post Hoc, Ergo Propter Hoc, Address at the U.S. Chamber of Commerce (Oct. 17, 2018), https://www.ftc.gov/public-statements/2018/10/prepared-remarks-commissioner-phillips.

[5] Tim Wu, *Be Afraid of Economic "Bigness." Be Very Afraid.*, N.Y. TIMES (Nov. 10, 2018, 9:27 AM), https://www.nytimes.com/2018/11/10/opinion/sunday/fascism-economy-monopoly.html.

[6] Josh Marshall, *A Serf on Google's Farm*, TPM EDITORS' BLOG (Sept. 1, 2017, 12:42 AM), https://talkingpointsmemo.com/edblog/a-serf-on-googles-farm.

[7] Eric Posner & Glen Weyl, *The Real Villain Behind Our New Gilded Age*, N.Y. TIMES (May 1, 2018, 8:28 PM), https://www.nytimes.com/2018/05/01/opinion/monopoly-power-new-gilded-age.html.

everyone ought to agree is a serious matter.[8] This may make for good politics, but I don't think the way we talk about the issue furthers good policy. So, today, I want to add a little history and learning to this conversation, to add a bit more nuance to our talk about breakups. I want to talk about what people mean when they call for breaking up monopolies. When is it appropriate? What does history tell us about government attempts to do so?

Monopolization & Section 2 of the Sherman Act

In antitrust speak, how have structural remedies been applied in "non-merger" or "anticompetitive conduct" cases under Section 2 of the Sherman Act? I know not everyone here specializes in antitrust, so let me define some terms and provide some background.

First, the law. Since 1890, Section 2 has condemned "every person who shall monopolize, or attempt to monopolize, or combine or conspire. . .to monopolize. . . ."[9] The Supreme Court interprets the monopolization offense to require both monopoly power in the market at issue *and* anticompetitive conduct.[10] Just being a monopoly, and even charging monopoly prices, are not themselves violations, because monopoly may be achieved through competition on the merits, which benefits

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[8] Astead W. Herndon, *Elizabeth Warren Proposes Breaking Up Tech Giants Like Amazon and Facebook*, N.Y. TIMES (Mar. 8, 2019), https://www.nytimes.com/2019/03/08/us/politics/elizabeth-warren-amazon.html. Senator Warren put out a plan to break up Google, Facebook and Amazon. When asked in an interview whether she also wanted to break up Apple, she reportedly said "yep", as if that was an easy answer. Nilay Patel, *Elizabeth Warren Wants to Break Up Apple, Too*, THE VERGE (Mar. 9, 2019, 6:19 PM), https://www.theverge.com/2019/3/9/18257965/ elizabeth-warren-break-up-apple-monopoly-antitrust.
[9] 15 U.S.C. § 2.
[10] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

consumers and society.[11] To break the law, to warrant any remedy (including breakup), you need both to be a monopolist and to take anticompetitive action, conduct, to acquire or maintain your monopoly.[12]

Second, the remedies. Antitrust law exists to remedy failures in well-defined markets, not to structure markets according to a central plan.[13] As in any kind of law enforcement, we should target the remedies we seek at what the law prohibits, what we seek to stop. A structural remedy seeks to change the structure of a firm or a market, say by breaking it up in some way, like a divestiture or a dissolution. The most common example of this is when, as a condition of approving a merger, an antitrust agency requires the merging companies to divest an asset. A behavioral remedy, by contrast, targets a firm's conduct, by proscribing certain practices and/or requiring others.

Today, we are not talking about mergers.[14] While Section 2 has been applied to mergers in the past, its requirement of proving monopoly, the Hart-Scott-Rodino pre-merger review process, and the Clayton Act's explicit applicability to pending mergers mean that most Section 2 cases are conduct cases. The "non-merger" or

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[11] *Id.*

[12] *Id.* For example, the Supreme Court has held that product tying, predatory pricing, and refusals to deal with rivals can constitute anticompetitive conduct under Section 2. Eastman Kodak Co. v. Image Tech. Servs., 504 U.S. 451, 480-86 (1992) (tying); Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993) (predatory pricing); *Trinko*, 540 U.S. at 408 (refusals to deal).

[13] *See* N. Pac. Ry Co. v. United States, 356 U.S. 1, 4 (1958) ("The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress").

[14] I will discuss mergers at certain points, but unless explicitly stated otherwise, the reader should assume that I am discussing remedies in the non-merger context. By "mergers", I mean both mergers and acquisitions.

"anticompetitive conduct" cases at issue here exclude those in which a divestiture is ordered to remedy pending or recently-consummated mergers. In merger cases, a structural remedy *preserves* the market structure. In conduct cases, it *disrupts* it.

Where conduct triggers Section 2 liability, antitrust agencies and courts almost always seek behavioral remedies—we seek to stop the illegal conduct.[15] The idea is simple: fix what's preventing competition, and then let firms compete. For example, a week and a half ago, the FTC sued a company called Surescripts under Section 2, for monopolizing the e-prescription eligibility and routing markets.[16] All five FTC commissioners voted to sue the company and to seek a behavioral remedy, to stop Surescripts from conduct that we allege is preventing competition.

We target illegal conduct, not companies we don't like. So, identifying the conduct and stopping it is the preferred approach to Section 2 violations. It is far from obvious why structural relief is necessary to solve behavioral problems. Why, if our goal is to stop bad conduct, is breaking up a company the way to go? What does a breakup accomplish that an injunction cannot? Even if one side-steps these thorny questions, we still need to grapple with the fact that, to borrow from Judge Frank Easterbrook, "breaking up is hard to do".[17]

<u>Lessons from History: Assessing Past Breakups</u>

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[15] *See* RICHARD A. POSNER, ANTITRUST LAW 106-07 (2d ed. 2001); United States v. E. I. du Pont de Nemours & Co., 366 U.S. 316, 329 (1961) ("[d]ivestiture or dissolution has traditionally been the remedy for Sherman Act violations whose heart is intercorporate combination and control").

[16] *FTC Charges Surescripts with Illegal Monopolization of E-Prescription Markets*, U.S. FED. TRADE COMM'N (Apr. 24, 2019), https://www.ftc.gov/news-events/press-releases/2019/04/ftc-charges-surescripts-illegal-monopolization-e-prescription.

[17] Frank H. Easterbrook, *Breaking Up Is Hard to Do*, 5 REGULATION 25 (1981).

Using antitrust to break up companies was never common practice in U.S. history, even in the law's early days. Of the single-firm monopolization cases brought by the government, fewer than 20% resulted in substantial divestiture, whether the sample runs from 1890 through 1939 or is extended through 1999.[18] Focusing only on non-merger cases, the percentage drops below 10%.[19] The most famous antitrust breakups are *Standard Oil* in 1911 and *AT&T* in 1984. The contrasts between the two are instructive, but neither experience should whet our appetite for breaking up companies without a good basis and the right conditions.

The *Standard Oil* Breakup (1911)

You might be surprised to learn that the breakup of Standard Oil, the infamous Rockefeller oil trust, formally ended earlier this *month*, when the Department of Justice (DOJ) moved a court to end the 1911 decree, from 108 years ago.[20]

The government sued Standard Oil under Sections 1 *and* 2 of the Sherman Act.[21] The complaint alleged that the Standard Oil Company of New Jersey, some 70 subsidiary corporations and partnerships, and seven individuals conspired to restrain trade in petroleum, refined oil, and other petroleum products, and

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[18] *See* POSNER, *supra* note 15, at 106.
[19] *See id*.
[20] Timothy Puko, *Too Soon? DOJ Seeks to End 1911 Standard Oil Breakup, Horseshoe Regulation*, WALL ST. J. (Apr. 16, 2019, 5:35 pm), https://www.wsj.com/articles/justice-department-closes-book-on-landmark-standard-oil-breakup-11555418344.
[21] Section 1 bars agreements that unreasonably restrain trade between firms, as opposed to Section 2, which can reach the conduct of a firm acting on its own. 15 U.S.C. §§ 1, 2; *Guide to the Antitrust Laws: Single Firm Conduct*, U.S. FED. TRADE COMM'N, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct; *Single Firm Conduct and Section 2 of the Sherman Act: An Overview*, n. 52, U.S. DEP'T OF JUSTICE, https://www.justice.gov/atr/competition-and-monopoly-single-firm-conduct-under-section-2-sherman-act-chapter-1.

attempted to and did monopolize those lines of commerce.[22] The lower court held the defendants liable under Sections 1 and 2, and ordered the dissolution of Standard Oil.[23] The Supreme Court affirmed the breakup ruling.[24]

The *first* thing the history of *Standard Oil* teaches is that it was not so much a case about anticompetitive conduct—the breakup remedy was really aimed at the combination it sought to undo. Standard Oil was, at the time, a New Jersey corporation that became the repository of stock following the Ohio Supreme Court's 1892 dissolution of the original Rockefeller oil trust. While the U.S. Supreme Court's opinion is sometimes difficult to follow, it grounds liability both in the combinations creating the trust and in conduct including "[r]ebates, preferences, and other discriminatory practices in favor of the combination by railroad companies" and "unfair methods of competition, such as local price cutting at the points where necessary to suppress competition".[25]

The Court expressed general support for remedies that would bar Standard Oil from anticompetitive conduct in the future, presumably including the rebates, preferences, etc., that I just mentioned.[26] When justifying the breakup, however, the grounds it gave were that the trust's creation violated the law, stating:

> So far as the decree held that the ownership of the stock of the New Jersey corporation constituted a combination in violation of the 1st section and an attempt to create a monopoly or to monopolize under

[22] Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 31 (1911).
[23] United States v. Standard Oil Co. of New Jersey, 173 F. 177, 192-93 (C.C.E.D. Mo. 1909), aff'd as modified, *Standard Oil*, 221 U.S. 1.
[24] *Standard Oil*, 221 U.S. at 77-82.
[25] *Id*. at 42-43.
[26] *Id*. at 77-79 (requiring a remedy that, in part, "forbid[s] the doing in the future of acts like those which we have found to have been done in the past which would be violative of the statute.").

> the 2d section, and commanded the dissolution of the combination, the decree was clearly appropriate.[27]

So, while the Supreme Court affirmed Standard Oil's antitrust liability based on the combinations creating the trust *and* the trust's exclusionary conduct, the illegality of the trust's 1882 formation and subsequent reorganization was essential to the breakup order. While a few subsequent cases have applied structural remedies in response to single firm conduct—*AT&T* is one example—*Standard Oil*, the most famous breakup, may not be such a compelling precedent.[28] The Court not only required monopolization; it required the combination it would unwind have *caused* it.

Another thing about *Standard Oil*: it's not clear the remedy worked. While the breakup is historically significant, the evidence it served those it should have—consumers—is not encouraging. *First*, the dissolution spun off the stock of each operating company within the trust to Rockefeller and his associates—the same small group who had owned the trust's stock.[29] *Second*, by simply undoing the holding company, the decree produced an industry structure that was largely a product of Standard Oil's pre-breakup corporate organization.[30] As Judge Richard Posner has pointed out, "[t]he decree had substituted a series of regional monopolies

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[27] *Id.*
[28] *See* POSNER, *supra* note 15, at 38 ("Unfortunately, the Court's opinion was murky. In particular it left unclear the extent to which the illegality of the Standard Oil Trust depended on various improper, and possibly anticompetitive, practices—such as extracting secret rebates from railroads, selling below cost to destroy or intimidate local competitors, and evading state regulatory authority—that may not have been essential to its achieving and maintaining monopoly power.").
[29] *Standard Oil*, 173 F. at 197.
[30] Robert W. Crandall, *The Failure of Structural Remedies in Sherman Act Monopolization Cases*, 80 OR. L. REV. 109, 134 (2001).

for a national monopoly."[31] How that spurred competition is far from clear. One attempt to measure the breakup's economic impact found a negative effect on output in 1912,[32] and pretty much the FTC's first job upon its creation in 1915 was to issue a report addressing a dramatic *increase* in gasoline prices.[33] I am not saying that the dissolution harmed competition, but the evidence that the *Standard Oil* breakup significantly increased competition or benefited consumers is not compelling.[34]

Third, by 1911, the American oil industry was already getting more competitive. Standard Oil's market shares in crude oil and gasoline had been declining even before the district court's decision in 1909, falling from the about 85% at the beginning of the 20th century to about 65% by 1911 and 1912. Its competitors, led by firms like the Union Oil Company, the Gulf Oil Corporation, Sun Oil, and the Texas Company, sourced from vast, newly-discovered finds in Oklahoma, Texas, and California—areas where Standard Oil lacked a strong presence.[35] By 1911, these areas accounted for the majority of the nation's oil supply.[36] In other words, by the time the Supreme Court ordered Standard Oil

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[31] POSNER, *supra* note 15, at 107.
[32] Crandall, *supra* note 30, at 131.
[33] U.S. FED. TRADE COMM'N, REPORT ON THE PRICE OF GASOLINE IN 1915 (Apr. 11, 1917), https://babel.hathitrust.org/cgi/pt?id=uiug.30112044913454;view=1up;seq=3.
[34] Using the relatively poor performance of U.S. Steel (which was not broken up) as a counterfactual, one study found that the dissolution of Standard Oil "had generally positive consequences for…the petroleum industry", although "there were only modest effects" immediately after the divestiture because "there was little immediate increase in the intensity of competition." William S. Comanor & F. M. Scherer, *Rewriting History: The Early Sherman Act Monopolization Cases*, 2 INT'L J. ECON. BUSINESS 263, 285 (1995). This work is worth considering, but it struggles to control for all of the exogenous changes that affected the oil and steel industries during the period over which it attempts to observe an effect.
[35] *See* POSNER, *supra* note 15, at 107-08; Crandall, *supra* note 30, at 129, 135.
[36] Crandall, *supra* note 30, at 129.

broken up, market forces were dissipating its dominance. Not only did it accomplish little in terms of competition, the breakup may not have been necessary at all to getting rid of the monopoly.

The *AT&T* Breakup (1984)

The next breakup on which I want to focus is AT&T, in 1984, perhaps the other most significant use of Section 2 to split up a large American company.

The DOJ filed its complaint against AT&T in 1974, alleging that the company, Western Electric, and Bell Telephone Laboratories had violated Section 2. The government claimed an unlawful combination and conspiracy between the defendants, the Bell Operating Companies (the "Baby Bells"), and others, which allegedly allowed AT&T to maintain control over the two other defendants and the Baby Bells, to limit competition from other telecomm providers, and to maintain a "monopolistic manufacturing and purchasing relationship between Western Electric and the Bell System".[37] The discovery process lasted seven years, with trial beginning in January 1981. Many months later, but still one month before the very long trial was scheduled to end, the parties agreed on settlement terms that were approved by the court, with modifications, in August of that year.[38]

The final decree was complex and multifaceted; so I will focus on the provisions relating to the divestiture of the Baby Bells and their impact on long-distance services. The purpose of the breakup was to boost competition in this market, not competition between the Baby Bells, which were to become regional

[37] United States v. American Tel. & Tel. Co., 461 F.Supp. 1314, 1317-18 (D.D.C. 1978).
[38] United States v. American Tel. & Tel. Co. (*AT&T*), 552 F.Supp. 131, 139-40, 225 (D.D.C. 1982).

monopolies.[39] The government's theory was that owning the Baby Bells allowed AT&T to foreclose competition in long-distance services and telecomm equipment, by denying long-distance competitors the necessary local interconnections to the Baby Bells. So, in addition to splitting them up, the decree also required the Baby Bells to make their switching facilities equally accessible to long-distance providers.[40]

Judge Posner called the breakup of AT&T arguably the most successful structural remedy in U.S. antitrust history.[41] He was speaking in relative terms, and I think he's probably right. There is strong evidence and broad consensus that that the telecommunication industry's competitiveness increased following the 1984 breakup.

As with Standard Oil, the divestiture's effects are difficult to isolate because the telecommunications industry experienced unrelated changes, like deregulation and new technologies, around the same time.[42] Unlike Standard Oil, however, AT&T's high pre-divestiture share of the long-distance market had been stable, and fell significantly after the breakup, as competitors entered or expanded.[43] That suggests the divestiture achieved gains that market forces and regulatory measures

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[39] *Id*. at 141; POSNER, *supra* note 15, at 110; Joseph H. Weber, *The Bell System Divestiture: Background, Implementation, and Outcome*, 61 FED. COMM. L.J. 21, 24-25 (2008).
[40] *AT&T*, 552 F.Supp. at 142-43.
[41] POSNER, *supra* note 15, at 111.
[42] NAT'L RESEARCH COUNCIL, BROADBAND: BRINGING HOME THE BITS 298 (2002), https://www.nap.edu/read/10235/chapter/11; Crandall, *supra* note 30, at 182. By the mid-1970s, the FCC had lifted many restrictions on the telephone terminal equipment end users could connect to their networks, fostering competitive markets for handsets, fax machines, private branch exchanges, and other hardware. NAT'L RESEARCH COUNCIL, *supra*, at 298; Crandall, *supra* note 30, at 182.
[43] Crandall, *supra* note 30, at 186-87.

had failed to deliver, though the organization of the Baby Bells and the regulatory structure of the telecommunications industry played significant roles.[44]

Recognizing the success of the AT&T breakup, it's helpful still to consider the breakup relative to alternatives the government might have sought, in particular requiring AT&T to offer interconnections on fair and nondiscriminatory terms to all telecommunications firms.[45] I mention this approach because of its similarity to the platform neutrality proposals popular in some camps.[46] While this approach raises its own concerns,[47] it helps to frame the question of exactly how much competition the breakup remedy injected at the margin. Studies comparing post-breakup developments in U.S. telecomm markets to those in Canada and the E.U., after those jurisdictions mandated equal-access interconnection, find similarly robust entry and erosion of incumbent market share, without breakups.[48] These analyses are subject to reasonable criticisms, but they highlight a question I asked earlier: why, in a conduct case, is breakup better than a behavioral remedy?

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[44] *See* Weber, *supra* note 39, at 27-28 (describing the technical and logistical challenges of reconfiguring the Baby Bells to operate effectively post-divestiture and the FCC continued regulation of AT&T).

[45] *See* Richard A. Epstein, *The AT&T Consent Decree: In Praise of Interconnection Only*, 61 FED. COMM. L.J. 149 (2008).

[46] *See*, *e.g.*, *Creating Effective Rules for Internet Platforms*, ROOSEVELT INST. (Nov. 13, 2018), http://rooseveltinstitute.org/wp-content/uploads/2019/01/Crafting-Effective-Rules-for-Internet-Platforms_Pt.-3_final-1.pdf?utm_source=rss&utm_medium=rss.

[47] *See*, *e.g.*, William E. Kovacic, *Designing Antitrust Remedies for Dominant Firm Misconduct*, 31 CONN. L. REV. 1285, 1310-11 (1999) (discussing the "adverse side effects" of mandated access).

[48] Eli M. Noam, *Did AT&T Die in Vain? An Empirical Comparison of AT&T and Bell Canada*, 61 FED. COMM. L.J. 119, 123-24 (2008); Crandall, *supra* note 30, at 186-89. Canada in particular offers a good comparison because Bell Canada and AT&T were about equally dominant in their respective markets when each was required to provide interconnection. And yet, although Bell Canada remained vertically integrated, long-distance prices fell faster in Canada than in the U.S., and are dramatically lower in the former for residential long-distance calls. Crandall, *supra* note 30, at 190; Noam, *supra*, at 124-25.

A side note about administrative costs. One oft-mentioned advantage of structural relief over behavioral is that the former requires less oversight by the agencies and courts—less regulation. But *AT&T* shows us that this is not a given. The breakup created a system in which calls had to be routed from one local exchange carrier to a long-distance carrier and then to a different local exchange carrier. Regulating these interconnections required ongoing oversight by the court, the FCC, and the DOJ, to ensure appropriate rate-setting and access.[49] Let me clarify: I am not claiming the behavioral remedy would have avoided these costs; any scheme based on interconnections would have presented similar challenges. Rather, I see two key takeaways. *First*, structural relief—especially relief that restructures a market, unlike in the merger divestiture process—can be just as costly to administer as the behavioral alternative. *Second*, whether structural remedies are less costly depends on the case, including the resulting market structure, the technology, and the applicable regulation already in place. The lesson is that, outside the merger context, we should resist a knee-jerk preference for structural remedies based on assumptions about administrability.

While *Standard Oil* and *AT&T* are not the only cases in which Section 2 was used to break up American businesses, they are considered landmarks. Contrary to what that status implies, however, taken together they hardly suggest the remedy is something that ought broadly to be applied, and certainly not without regard to the conduct at issue or the nature of the business. I do not have time to discuss the other Section 2 breakup cases, but evidence suggests that structural relief has not

[49] Epstein, *supra* note 45, at 160; *see also* Kovacic, *supra* note 47, at 1295, 1303.

in general fared well.[50] That history also shows breakup remedies like these are exceedingly rare, and so the government has much less experience with them.[51]

Breaking Up Is Hard to Do

It's little wonder, then, that agencies and courts are not, like politicians and pundits, champing at the bit to break up companies. While the law contemplates doing so—and doing so sometimes *is* warranted—enforcement experience and economic research show us that the treatment may be worse than the disease and, in some cases, simply not doable.[52]

High Uncertainty

Seeking a breakup remedy in an antitrust case requires a judgment that the resulting market structure will leave competition and consumers better off. Consider that for a moment: breaking up a company is, quite directly, the government using the force of law to substitute its vision of how an industry can and should be structured, for how the market has actually worked. That alone should make one pause and appreciate the gravity of the proposal. Antitrust enforcers are not industrial planners. As Judge Easterbrook wrote, we should not

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[50] *See* Crandall, *supra* note 30, at 197 (review of the major Section 2 cases won by the government or ending in consent decrees found little evidence that structural relief had a positive effect on competition and consumer welfare); POSNER, *supra* note 15, at 107-11 (same). *See also* Richard A. Epstein, *Monopolization Follies: The Dangers of Structural Remedies under Section 2 of the Sherman Act*, 76 ANTITRUST L.J. 205, 207 (2009).

[51] POSNER, *supra* note 15, at 106-07. When it comes to merger enforcement, by contrast, the U.S. antitrust agencies have very substantial experience using structural remedies to resolve competitive concerns raised by pending mergers. From 2006 through 2012, for instance, the FTC alone entered 76 merger consent orders that imposed some form of structural relief. U.S. FED. TRADE COMM'N, THE FTC'S MERGER REMEDIES STUDY 2006-2012: A REPORT OF THE BUREAUS OF COMPETITION AND ECONOMICS 7 (Jan. 2017), https://www.ftc.gov/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics [hereinafter FTC MERGER REMEDIES STUDY].

[52] Some of these considerations might also apply in the merger context, but that is a topic for another time.

"fall prey to the nirvana fallacy, the belief that if a cost or flaw in existing affairs can be identified, it must follow that some other state of affairs (the 'remedy') is better."[53]

When we seek a divestiture in a merger case, we know how competition looks. The remedy seeks to preserve competition as it is (or recently was), not an untested state of affairs that we regulators might believe superior. Although some uncertainty remains in merger cases, it is far less than the uncertainty of breakups in non-merger cases. In a non-merger case, if we wish to restructure a market, why do we presume our vision for how that market ought to work will, in fact, work, much less actually work better? These are tough questions. And antitrust requires that they be answered only by one agency and one (or a few) judges.

My argument here rests on the small-c conservative principle that, the greater the proposed interference with the status quo of a complex system like a market, the less confident we should be of the desired outcome, both that it will be the outcome and, if so, that it will be desirable. This principle acknowledges the nirvana fallacy and counters with a sober assessment of our limited ability to control complexity and guard against unintended consequences.

Courts require us to adopt this sensible approach. In *U.S. v. Microsoft*, the U.S. Court of Appeals for the D.C. Circuit overturned the trial judge's breakup

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[53] Easterbrook, *supra* note 17, at 26. Judge Easterbrook's definition of the nirvana fallacy is equivalent to Professor Harold Demsetz's the-grass-is-always-greener fallacy, one of the three fallacies Demsetz argued are inherent to what he dubbed "the nirvana approach"—the mistaken practice of finding a state of affairs to be inefficient if it compares unfavorably with the ideal, rather than with realistic, achievable alternatives. Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 2-3 (1969).

order, explaining: "divestiture is a remedy that is imposed only with great caution, in part because its long-term efficacy is rarely certain."[54] It went on to require "a clearer indication of a significant causal connection between the conduct and creation or maintenance of the market power" where the remedy is structural relief.[55] This is the *first* critical lesson, and harkens back to *Standard Oil*: we need a clear link between the cause (conduct or combination) and the monopolization where breakups are at issue. It's not enough to point out conduct you don't like—even anticompetitive conduct—it has to be linked to the firm's market power. Just explaining how a breakup will solve a conduct problem is not easy, much less actually proving it—which, by the way, is what we as agencies need to do.

The conservative principle also plays a central role in distinguishing breakups for anticompetitive conduct from divestitures for anticompetitive mergers. This remedy directed at conduct aims to bring competition where bad conduct has prevented it, but the link between the bad conduct and the remedy, and then between the remedy and the competition we hope to have, is far from obvious. To argue for breakup as a remedy, one must show, at a minimum, that the market structure contributed to the harmful conduct, that the breakup is very likely to enhance competition and benefit consumers by eliminating the bad conduct, and that behavioral alternatives do not offer equal or greater expected benefits at equal or lower costs.

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[54] United States v. Microsoft Corp., 253 F.3d 34, 80 (D.C. Cir. 2001).

[55] *Id*. at 106 (quoting 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 653b, at 91-92).

The D.C. Circuit in *Microsoft* faulted the lower court for devoting "a mere four paragraphs of its order to explaining its reasons for the remedy",[56] which brings us to the *second* lesson: you need a lot more information to determine whether a breakup will help solve anticompetitive conduct. The goal, by the way, is to solve the problem; not to punish the wicked, or bring low the mighty. Antitrust is a not a Biblical morality play. It's about solving specific problems, market failures that we can prove in court. Unlike in a merger case, where you prove liability by showing a likelihood of lessened competition *from a change to the existing market structure*, a liability determination in a Section 2 case may well indicate that the illegal conduct reduced competition; but it offers scant guidance on how the market would look absent that conduct. So determining that a given remedy—say, a breakup—will help, is another matter entirely.

Implementation Risk

Breakups also present considerable practical challenges. *First*, along which lines will you divide the firm? The breakups in *Standard Oil* and *AT&T* were at least relatively straightforward in this respect. There were distinct and largely independent business units to separate from each other.[57] But many firms may lack clear lines related to the anticompetitive conduct.[58] In the 1947 case against United Shoe Machinery, the government prevailed on liability and asked the court to "dissolve United into three separate manufacturing companies."[59] The judge

[56] *Id*. at 103.
[57] Kovacic, *supra* note 47, at 1301-02.
[58] *Cf. id*. at 1294-95.
[59] United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 348 (D. Mass. 1953).

refused, on the grounds that United conducted all manufacturing at a single plant, "with one set of jigs and tools, one foundry, one laboratory for machinery problems, one managerial staff, and one labor force."[60] "It takes no Solomon," the judge concluded, "to see that this organism cannot be cut into three equal and viable parts."[61] And you don't need to be Solomon to realize that proposing identical—and drastic—remedies for businesses that look nothing alike probably isn't taking into account the facts of the case. How do fair judges get comfortable? They weren't in *Microsoft*.

Second, even if a breakup is possible, what will become of the resulting pieces? The breakup will fail unless separated entities survive in their respective markets; otherwise the welfare effects would be unambiguously negative.[62] That's not so easy. The FTC and DOJ have regularly dealt with this challenge when implementing structural relief in merger cases. The goal is to maintain the competition that the merger would have eliminated, which requires that the divested assets remain in the market at their current competitive strength for the foreseeable future. Repeated experience has crystalized certain lessons showing that much labor, care, and information are necessary, but not sufficient, conditions for successful breakups. We know, for example, that divestitures of an ongoing business are more likely to succeed than divestitures of some lesser bundle of

[60] *Id.*
[61] *Id.*
[62] As Professor Kenneth Elzinga said of structural merger remedies: "Along with reestablishing the acquired firm, it is also necessary that this 'new' firm be made *viable*; a mere shadow of its former self is not acceptable. Indeed, reestablishing 'new' firms that are unable to stand on their own would make any relief efforts farcical." Kenneth G. Elzinga, *The Antimerger Law: Pyrrhic Victories*, 12 J.L. & ECON. 43, 45 (1969) (emphasis in original).

assets, even if there is an upfront buyer.[63] And, even then, success is not guaranteed; in three recent merger-related divestitures, the divestiture buyers went bankrupt or otherwise dropped out of the market.[64] All these challenges and risks of actually following through are at least as acute in the non-merger context.

High Costs

The *Standard Oil* and *AT&T* experiences, and my discussion up to now, illustrates to me the speculation and difficulty involved in realizing some of the putative gains of breaking up companies. That is only the benefit side of the equation. Antitrust enforcers also should consider the costs. I mentioned administrative costs earlier; but breakups can also reduce efficiency and incentives to enter and innovate, with consumers ultimately paying the price.

Bigness and high market concentration may be the result of anticompetitive conduct, but they may also stem from factors that increase welfare, such as superior products or services, lower costs and quality-adjusted prices, and more successful innovation.[65] Both E.U. Competition Commissioner Vestager, and Professor Herbert Hovenkamp, a leading antitrust scholar, raised this point when expressing serious doubts about recent calls to break up large tech firms, noting that many of these

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[63] FTC MERGER REMEDIES STUDY, *supra* note 51, at 5, 21-22. Most divestitures involve sale to an acquirer who will provide the appropriate backing, because that involves far less risk and takes far less time than standing up a new, independent firm. At the same time, the sale must not raise competitive issues of its own. Further due diligence is necessary to ensure that the buyer has the incentives, resources, and transitional services to keep the assets competitive, and that the seller is not withholding important information. *Id*. at 24-25.

[64] The mergers were Hertz/Dollar Thrifty, Albertsons/Safeway, and Dollar Tree/Family Dollar. Pallavi Guniganti, *Feinstein denies FTC divestiture failures,* GLOBAL COMPETITION REVIEW (Sept. 29, 2017), https://globalcompetitionreview.com/article/usa/1147830/feinstein-denies-ftc-divestiture-failures.

[65] *See*, *e.g.*, 3 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 637 (4th ed. 2018); *cf.* Harold Demsetz, Two Systems of Belief about Monopoly, in INDUS. CONCENTRATION, THE NEW LEARNING 164, 177 (Harvey J. Goldschmid et al. eds., 1974).

firms have grown due to competitive (or zero) pricing, "high consumer satisfaction", and because "a lot of people like their products".[66] The basic difficulty in non-merger cases is knowing the extent to which a defendant's market power is a function of efficiency and competition or of antitrust violations. Where the former, the remedy can be harmful; and breaking up breaks even more.[67]

Vertical integration—that is, having within a single firm at least two different levels of production—is another source of potentially significant efficiencies that a breakup may eliminate.[68] A substantial body of economic literature indicates that vertical integration "eliminates double marginalization" because the firm has the incentive to sell to itself at cost, which in turn places downward pressure on the firm's prices to its customers. It also overcomes coordination problems and conflicting incentives between unintegrated firms that cannot efficiently be addressed by contracts. Vertical integration has thus produced lower costs and prices, greater product innovation, and better quality for consumers, motivating some economists to oppose the government's proposed vertical breakup of Microsoft.[69] Economic studies of vertical integration have found "that, under most circumstances, profit-maximizing vertical-integration decisions

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[66] Stephanie Bodoni & Aoife White, *Breaking Up Tech Giants Would Be Hard to Do, EU's Vestager Says*, BLOOMBERG LAW (Jan. 25, 2019, 7:11 am), https://news.bloomberglaw.com/tech-and-telecom-law/breaking-up-tech-giants-would-be-hard-to-do-eus-vestager-says-1; Herbert Hovenkamp, *The Warren Campaign's Antitrust Proposals*, REG. REV. (Mar. 25, 2019), https://www.theregreview.org/2019/03/25/hovenkamp-warren-campaigns-antitrust-proposals/.
[67] *See* 3 AREEDA & HOVENKAMP, *supra* note 65, ¶ 653; Demsetz, *supra* note 65, at 179.
[68] *See*, *e.g.*, Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. ECON. LIT. 629 (2007); James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005).
[69] Paul Krugman, *Reckonings; Microsoft: What Next?*, N.Y. TIMES, Apr. 26, 2000, at A21; Paul Krugman, *Reckonings; Dirty Windows Policy*, N.Y. TIMES, Apr. 30, 2000, at A19; Robert W. Hahn, *Breaking up Is Hard to Do so Don't Do It*, L.A. TIMES, Apr. 30, 2000, at M5.

are efficient, not just from the firms' but also from the consumers' points of view."[70] The economic evidence against breaking up vertical integration is also very compelling. Lafontaine and Slade's review of the literature found "clear evidence that restrictions on vertical integration that are imposed . . . on owners of retail networks are usually detrimental to consumers."[71]

Breakups can also reduce the incentive to innovate, an important part of competition. Markets characterized by high rates of innovation and product development may remain highly concentrated or monopolized but still be competitive, as firms try to out-innovate each other for temporary market dominance—"creative destruction", in the words of Joseph Schumpeter.[72] Many innovation markets also display "network effects", meaning that the product becomes more valuable to consumers, relative to competing products, as more consumers use it.[73] Telephone networks, software, and online platforms and networking sites are common examples. While generating benefits, network effects also can create lock-in, path dependence, and high barriers to entry, because firms that gain significant market penetration early on may enjoy significant advantages over laggards and because most or all of the market may eventually "tip" to an incumbent who can only be dislodged by a superior product or a significant cost

[70] Lafontaine & Slade, *supra* note 68, at 680; *see also* Cooper et al., *supra* note 68, at 658 ("Overall, we would characterize the empirical literature on vertical restraints/vertical integration as follows: Most studies find evidence that vertical restraints/vertical integration are procompetitive").
[71] Lafontaine & Slade, *supra* note 68, at 680.
[72] Howard A. Shelanski & J. Gregory Sidak, *Antitrust Divestiture in Network Industries*, 68 U. CHI. L. REV. 1, 10-12 (2001).
[73] *See*, *e.g.*, Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424 (1985).

advantage. The *Surescripts* complaint addresses this issue head-on.[74] At the same time, high payoffs from achieving dominance, maintaining dominance, or stealing dominance can spur significant innovation and competition.

Note that, in these circumstances, market power *is* the payoff and what look like profits above the competitive level may actually be recoupment of high expenditures for entry or innovation. Both law and economics recognize the importance of this innovation-promoting dynamic. In *Trinko*, Justice Scalia explained:

> The opportunity to charge monopoly prices—at least for a short period—is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.[75]

And, in endorsing the behavioral consent in *Microsoft* in 1995, Nobel-laureate economist Kenneth Arrow likewise observed:

> [N]otice that most of the steps in the dynamic process leading to monopoly or imperfect competition are steps in which the growth of the monopoly arises by offering a cheaper or superior product. . . . [A]ny set of remedies is likely to be of the form of penalizing whatever firm happens to be leading, Microsoft in this instance. This may take the form of disintegrating the firm horizontally or vertically or of imposing constraints on its ability to enter certain markets. A rule of penalizing market successes that are not the result of anticompetitive practices will, among other consequences, have the effect of taxing technological improvements and is unlikely to improve welfare in the long run.[76]

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[74] Complaint at 6-9, Fed. Trade Comm'n v. Surescripts, LLC, No. 1:19-01080-JDB (D.D.C. filed Apr. 17, 2019), https://www.ftc.gov/system/files/documents/cases/surescripts_redacted_complaint_4-24-19.pdf.

[75] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

[76] Declaration of Kenneth J. Arrow, attached to Memorandum of the United States of America in Support of Motion to Enter Final Judgment and in Opposition to the Positions of I.D.E. Corporation and Amici, *United States v Microsoft Corp.*, Civil Action No. 94-1564, 9 (D.D.C. filed Jan 18, 1995),

We would do well to heed these warnings.

To be clear, in the face of uncertainty as to whether a defendant's actions were procompetitive or anticompetitive, behavioral remedies run a similar risk of prohibiting or discouraging firms from acts that generate efficiency and improve consumer welfare. The key distinction is that behavioral remedies are more narrowly tailored to the specific conduct at issue, whereas the impact of structural relief is far more dramatic and has consequences well beyond the conduct at issue. Taking care not to condemn procompetitive conduct and taking care to minimize the fallout when we mistakenly do are not mutually exclusive. We should do both.

Conclusions

I have covered much ground today, so I will end by summarizing my main points. *First*, the historical record contains no "golden era" when breakups were the preferred remedy for Section 2 violations, and provides scant evidence that breakups are superior to more targeted behavioral relief. *Second*, the legal burden for justifying a breakup is, and should be, high. *Third*, for a variety of reasons, structural relief presents highly uncertain benefits and risks considerable costs—in many ways more so than behavioral remedies. *Finally*, breakups should be a last resort in non-merger cases—they should be pursued rarely and with great care.

Taking care is necessary in law enforcement, and in fashioning the public policy that drives it. A predicate to that is taking care in understanding the very real considerations and consequences that attend politics, in this case with regard

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https://www.justice.gov/sites/default/files/atr/legacy/2010/05/26/0049.pdf; *see also* Shelanski & Sidak, *supra* note 72, at 30-31; J. Gregory Sidak and Daniel F Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851, 919-20 (1996).

to antitrust. I hope this talk has helped that conversation along, and I look forward to continuing it with all of you.

Thank you.