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COMMENTS OF ITIF

Before the

California Law Review Commission Study of Antitrust Law

Washington, DC

In the Matter of: Single-Firm Conduct & Concentration in California	))))))))	Public Comment

May 2, 2024

A STRANGE VIBRATION: A NEW ANTITRUST EXPLANATION FOR MARKETS IN MOTION?

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INTRODUCTION

On January 25, 2024, the Single-Firm Conduct Working Group of the California Law Review Commission ("the Commission") Study of Antitrust Law issued a report ("Single-Firm Report") discussing potential reforms to California's antitrust laws, which included example statutory language for expanding the Cartwright Act to cover unilateral conduct.[1] Two months later, the Concentration in California Working Group issued another report ("Concentration Report") that assessed the state of competition in several core sectors of the Californian economy and expressed concerns about concentration.[2] The reports come amidst an ongoing process commissioned by the California legislature in 2022 to review the state's antitrust laws.[3]

The Information Technology and Innovation Foundation (ITIF) appreciates the opportunity to comment on the reports of the Single-Firm Conduct and Concentration in California Working Groups, and in particular to ensure that California and the United States more generally maintain their roles as the leading innovation hubs of the world. While ITIF applauds the Commission for its efforts to evaluate the adequacy of California's competition laws and consider possible changes, this comment highlights concerns with both the single-firm and concentration reports, and specifically regarding their respective legal and economic findings.

This comment proceeds in six parts. The first provides an overview of the innovation competition that defines Silicon Valley and has so greatly benefited California, the United States and the world. The second discusses the conclusions of the concentration report regarding increased concentration. The next section identifies several structural problems with the unilateral conduct regime contemplated by the single-firm report, with

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[1] A. Edlin et al., Single-Firm Conduct Working Group, California Law Review Commission Study of Antitrust (Jan 25. 2024) [hereinafter Single-Firm Report].

[2] C. Johnson et al., Concentration and Competition in California: A Focus on Critical Sectors and Labor Markets (Mar. 26, 2024) [hereinafter Concentration Report].

[3] *See* California Law Review Commission, Antitrust Law – Study B-750, Antitrust Law -- B-750 (ca.gov).

the following part critiquing its analysis of existing federal law as well as the proposed legal standards outlined in the example statutory language. The fifth provides several recommendations for the Commission to consider as it continues to review potential antitrust reforms. A brief conclusion follows.

INNOVATION AND DYNAMIC COMPETITION

Innovation is the greatest long-run driver of economic growth.[4] But it is by no means a law of nature. Rather, firms must overcome several problems if they want to innovate successfully. As distinct from the need to think creatively, or even more critically overcome the challenges associated with cannibalizing existing products,[5] a core difficulty involves the lack of certainty firms face when assessing whether the innovation will be profitable.[6] That is, a firm may invest substantial resources in a new technology only to find later that it is unable to appropriate the benefits wrought by its own innovation. And only in hindsight do we determine whether an innovation is successful: for every "Apple" or "Google" there are scores of failures.

Since the groundbreaking work of Joseph Schumpeter in the 1940s, it has long been understood that competition is not merely, as neoclassical economics holds, an equilibrium where price equals marginal cost. Nor is it simply, as Adam Smith imagined, a rivalry between many sellers in a market. Rather, as Schumpeter explained, innovation or dynamic competition can occur through "gales of creative destruction"[7] whereby one firm competes *for* the market by creating a new product, only to be challenged by additional "leapfrog competition"[8] that supplants the formerly dominant firm with a still newer product offered by a new market leader. This dynamic competition not only dazzles consumers with innovative products but allows firms to solve the appropriability problem by recouping the costs of their investments in innovation.

Schumpeter's insights have more than withstood the test of time. While the general relationship between market structure and innovation has long been a matter of great debate,[9] numerous studies across many economies around the world continue to confirm that the relationship often takes the form of an inverted-U, where markets characterized by many firms are less innovative than markets with a few firms, and markets with a few firms exhibit more innovation than those characterized by monopoly.[10] In fact, for some U.S.

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[4] *See* Robert M. Solow, *Technical Change and the Aggregate Production Function*, 39 REV. ECON. & STAT. 312 (1957); *see also* Charles I. Jones, *Sources of U.S. Economic Growth in a World of Ideas*, 92 AM. ECON. REV. 220 (2002).

[5] *See* Kenneth Arrow, *Economic Welfare and the Allocation of Resources to Invention*, *in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY: ECONOMIC AND SOCIAL FACTORS 609 (1962).

[6] *Id.* at 622 (conceding that "monopoly may create superior incentives to invent [because] appropriability may be greater under monopoly than under competition").

[7] JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY 81 (1942).

[8] *See, e.g.*, Thomas Barnett, *Interoperability Between Antitrust and Intellectual Property*, 14 GEO. MASON L. REV. 859, 860 (2007).

[9] *See* Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull's Eye? in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY REVISITED 367 (2012) (noting that, as concerns market structure and innovation, "general theoretical or empirical findings about these relationships remain elusive").

[10] *See* Philippe Aghion at al., *Competition and Innovation: An Inverted-U Relationship*, 120 Q. J. ECON. 701 (2005); Michael R. Peneder & Martin Woerter, *Competition, R&D and Innovation: Testing the Inverted-U in a Simultaneous System*, 24 J. OF EVOLUTIONARY ECON. 653 (2014) (Switzerland); Michiyuki Yagi & Shunsuke Managi, *Competition and Innovation: An inverted-U relationship using Japanese industry data*, Discussion Papers 13062, Research Institute of Economy, Trade and Industry (RIETI) (2013) (Japan); Michael Polder & Erik Veldhuizen, *Innovation and Competition*

studies the relationship is negative,[11] and thus strongly supportive of the Schumpeterian thesis that firms in less concentrated markets lack robust incentives to engage in the risk-taking and R&D that drives innovation.

The negative relationship between deconcentrated markets and innovation is particularly noticeable in the case of the incremental and process innovations that, as separate from the more drastic Schumpeterian gales, are also critical to improving productive efficiency and consumer welfare.[12] Indeed, studies have found that most of the innovation driven gains in growth come from incremental innovations by incumbents.[13] These types of incremental innovations are ubiquitous throughout the modern digital economy, and can include various forms of product integrations, design changes, self-preferencing, limitations on interoperability, and myriad types of other procompetitive, pro-innovation and pro-consumer behavior.

Viewed in this dimension, economic concentration is a feature—not a bug—of not just a competitive process to facilitate innovation and economic growth, but the evolution of capitalist society itself.[14] Indeed, Schumpeter's theory of innovation competition helps elucidate the amazing transformation of economic life in the Western world from a more atomistic economic system largely constituted by small and regional firms defined by static forms of competition to one driven by large, national, and now international concerns powered by scale economies and R&D-driven innovation—so many of which have long called California home and continue to lead the world in driving technological progress and economic growth.

Indeed, the success of Silicon Valley and the high-tech economy in America is a testament to Schumpeterian competition at work: for example, IBM's leadership in personal computing was displaced by Microsoft's paradigm shifting operating system, which was in turn leapfrogged both by Apple with its mobile platform as well as by Google (who surpassed Yahoo!) in general search, who in turn saw its position in advertising challenged by Facebook (overcoming MySpace) in social media. The cycle of creative destruction, which continues today (especially with AI), led to the rise of the American technology titans that are the economic envy of the world—each not only driving innovation, but competing with one another as they do it.[15] This

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in the Netherlands: Testing the Inverted-U for Industries and Firms, 12 J. of IND. COMPETITION AND TRADE 67 (2012) (Netherlands); Chiara Peroni & Ivete Gomes Ferreira, *Market competition and innovation in Luxembourg*, 12 J. OF IND, COMPETITION AND TRADE 93 (2012) (Luxembourg).

[11] *See, e.g.*, Spencer Yongwook Kwon, Yueren Ma, Kaspar Zimmerman, *100 Years of Rising Corporate Concentration*, SAFE Working Paper No. #359 (2023); David Autor et al., *Foreign competition and domestic innovation: Evidence from US patents*, 2 AMER. ECON REV. 357 (2020); Aamir Rafique Hashmi, *Competition and Innovation: The Inverted U Relationship Revisited*, 95 THE REVIEW OF ECONOMICS AND STATISTICS 1653 (2013).

[12] *See* Wesley M. Cohen, *Fifty years of empirical studies of innovative activity and performance*, in HANDBOOK OF THE ECONOMICS OF INNOVATION 129, 137 (2010).

[13] *See, e.g.*, Daniel Gracia-Macia, Chang Tai Hsieh, Peter J. Klenow, *How Destructive Is Innovation*, 87 ECONOMETRICA 1507 (Sept. 2019).

[14] SCHUMPETER, at 106 ("What we have got to accept is that [the large-scale establishment or unit of control] has come to be the most powerful engine of [economic] progress.…In this respect, perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency.").

[15] *See, e.g.*, NICOLAS PETIT, BIG TECH & THE DIGITAL ECONOMY THE MOLIGOPOLY SCENARIO 62–63 (2020) (stating that "while there is an undisputable trend toward industry concentration in the digital economy, there is also a competitive force behind it ... our analysis allows us to entertain doubts that big tech firms deserve to be considered as monopolies.").

technological leadership and rivalry has not only led to increased United States global market share, but made California the world's leading innovation hub.

CONCENTRATION IN CALIFORNIA

The concentration report has a different perspective on the past forty years: namely, that competition has declined as concentration has risen, especially due to mergers and acquisitions.[16] As ITIF has explained, many of the studies that find a significant increase in concentration are flawed, such as by using 3- or 4-digit NAICS codes to analyze concentration.[17] Indeed, an ITIF study analyzing Census data at the six-digit NAICS industry level found that the average C4 ratio only rose about 1 percentage point from 34.3 to 35.3 percent from 2002 to 2017.[18] Similarly, when expanding the analysis to C8 ratios, the increase was also about 1 percentage point.[19] Perhaps more importantly, the study found that only 35 (4 percent) of the 851 industries analyzed were "highly concentrated.[20] These findings are consistent with those of other studies analyzing specific product markets using purchasing data which also have found that concentration has declined.[21] Indeed, when looking more closely at geographic markets, a study by Rossi-Hansberg et al. concluded that concentration at the local level declined from 1990 to 2014.[22]

The concentration report also asserts that profits have risen as top companies take advantage of their purported market power to raise prices. And yet, an ITIF report concluded that nonfinancial domestic profits only rose 0.8 percentage points from 4.5 percent to 5.3 percent of GDP from 1990 to 2019.[23] Additionally, an ITIF analysis of 39 industries found that the correlation between change in concentration and profit shares reverses from 0.67 to -0.19 when the airline industry, an outlier in the data, is removed.[24] Further corroborating this finding, the report also found that small firms had higher profit rates.[25] Moreover, as with concentration, simply looking at measures like corporate profits says little about overall economic welfare: increases in corporate profits and market power can be a product not just of anticompetitive tactics, but

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[16] The report cites a well-known study by Kwoka, the problems with which have long been recognized. *See, e.g.*, Michael Vita & F. David Osinski, *John Kwoka's Mergers, Merger Control, and Remedies: A Critical Review*, 82 ANTITRUST L.J. 361 (2018).

[17] Joe Kennedy, *Monopoly Myths: Are Markets Becoming More Concentrated*, ITIF (June 2020), https://itif.org/publications/2020/06/29/monopoly-myths-are-markets-becoming-more-concentrated/

[18] Robert Atkinson and Filipe Lage de Sousa, *No, Monopoly Has Not Grown*, ITIF (June 2021), https://itif.org/publications/2021/06/07/no-monopoly-has-not-grown/.

[19] *Id.*

[20] *Id.*

[21] C. Lanier Benkard, Ali Yurukoglu, and Anthony Lee Zhang, *Concentration in Product Markets*, NBER Working Paper Series No. 28745 (April 2021).

[22] Esteban Rossi-Hansberg, Pierre-Daniel Sarte, and Nicholas Trachter, *Diverging Trends in National and Local Concentration*, Federal Reserve Bank of Richmond, Working Paper Series 18-15R (February 27, 2019), https://doi.org/10.21144/wp18-15.

[23] Joe Kennedy, *Monopoly Myths: Is Concentration Leading to Higher Profits* ITIF (April 2024), https://itif.org/publications/2020/05/18/monopoly-myths-concentration-leading-higher-profits/.

[24] *Id.*

[25] *Id.*

efficiency-enhancing and procompetitive behavior. Indeed, studies have found that higher markups are due to decreases in marginal costs flowing from technological progress.[26]

The concentration report specifically flags increasing labor market concentration as a concern, but again the picture it provides is incomplete. For example, one study showed that local labor market concentration has declined since 1976, with industries that had the highest decline being those with the highest level of labor market concentration.[27] Further corroborating these findings, another study found that while national labor market concentration at the three-digit NAICS industries has increased since the mid-1980s, concentration in local labor markets has declined over the same period.[28] Indeed, an ITIF report highlighted that if an occupation spans multiple industries, local labor market concentration may be even lower.[29] In other words, "the reality is that most of the markets with high levels of employer concentration are rural and small-town areas," affecting few people in absolute terms.[30]

The concentration report also argues that greater consolidation in the food and agricultural industry has raised prices for consumers. However, a 2009 Government Accountability Office report concluded that the empirical economic literature could not establish that "concentration in the processing segment of the beef, pork, or dairy sectors or the retail sector overall has adversely affected commodity or food prices."[31] Additionally, a more recent study found that from 1997 to 2012, food manufacturing concentration stabilized with the average C4 ratio in 2012 of only 48.8 percent.[32] Indeed, the study also found that a simple average of the 37 six-digit NAICS industries in this sector showed that the C4 ratio only increased by about 2.8 percent during this period.[33] Moreover, some studies that have identified increased concentration in the livestock and crop industry found that they are due to technological innovation that reduces time and labor

[26] *See, e.g.*, Hendrik Döpper et al., *Rising Markups and the Role of Consumer Preferences*, Harvard Business School Working Paper 22-025 (2022).

[27] Kevin Rinz, *Labor Market Concentration, Earnings Inequality, and Earnings Mobility*, CARRA Working Paper Series, no 2018–10 at 16 (September 2018), https://www.census.gov/library/working-papers/2018/adrm/carra-wp-2018-10.html.

[28] David Berger et al., *Labor Market Power*, NBER Working Paper, no. 25719 41–42 (March 2019), http://www.nber.org/papers/w25719.

[29] Julie Carlson, *Monopolies Are Not Taking a Fifth of Your Wages*, ITIF (April 2022), https://itif.org/publications/2022/05/02/monopolies-are-not-taking-fifth-your-wages/.

[30] Robert Atkinson, *The Myth of Local Labor Market Monopsony*, ITIF (April 2024), https://itif.org/publications/2021/05/07/myth-local-labor-market-monopsony/

[31] U.S. Government Accountability Office, Subject: U.S. Agriculture: Retail Food Prices Grew Faster Than the Prices Farmers Received for Agricultural Commodities, but Economic Research Has Not Established That Concentration Has Affected These Trends (June 30, 2009), https://www.gao.gov/assets/gao-09-746r.pdf.

[32] Tina Saitone and Richard Sexton, *Concentration and Consolidation in the U.S. Food Supply Chain: The Latest Evidence and Implications for Consumers, Farmers, and Policymakers*, Federal Reserve of Kansas City Economic Review, Special Issue (2017), https://www.kansascityfed.org/documents/764/Concentration_and_Consolidation_in_the_U.S._Food_Supply_Chain_The_Latest_Evidence_and_.pdf.

[33] *Id.*

inputs, rather than anticompetitive factors.[34] Such efficiencies mean that "consolidation has benefited consumers," helping to ensure that "[f]ood costs are a small and stable share of budgets for most Americans."[35]

The concentration report continues by suggesting that the pharmaceutical supply chain has become more consolidated, leading to rising costs. However, these concerns are exaggerated. Of the three levels in the supply chain identified in the report, the main culprit is PBMs, an industry where four companies controlled 68 percent of the market in 2021.[36] With respect to the pharmaceutical industry, which is the part of the supply chain that drives innovation, an ITIF study found that in 2006 the top 10 drug producers accounted for 56 percent of global industry sales, a number that fell to 43 percent by 2019.[37] Indeed, the critical biopharmaceutical industry has become less concentrated over time.[38] As such, the concentration report's concerns about rising costs in the highly regulated healthcare industry are at best a mixed bag.

The concentration report concludes its analysis with a claim that consolidation in the entertainment industry has increased with harmful exclusionary effects, which is based primarily on only two case studies. As such, the concentration report appears to overlook several elephants in the room, including not just the rise of social media giants like Alphabet and Meta but also over the top platforms offered by firms like Netflix and Hulu—all California firms who have radically and pro-competitively disrupted the media and entertainment landscape over the past few decades. Moreover, with respect to the specific examples noted in the report, as ITIF has argued regarding *Microsoft/Activision*, Microsoft is unlikely to foreclose its top competitor Sony from accessing the popular game Call of Duty and other popular content because the increase in Xbox sales is not guaranteed to outweigh the lost Call of Duty sales.[39] Indeed, Microsoft's past actions also corroborate this, as they have only made content exclusive to Xbox when its value is low.[40]

DESIGNING A UNILATERAL CONDUCT REGIME

Creating additional state antitrust liability should be a response to some failure of federal antitrust enforcement to adequately ensure competition and innovation in California. And yet, not only are concentration concerns misplaced, but California is again leading the next generation of dynamic competition in the form of artificial intelligence. As noted in its Executive Order on Artificial Intelligence, "California is

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[34] James MacDonald, *Consolidation, Concentration, and Competition in the Food System*, FEDERAL RESERVE BANK OF KANSAS CITY ECONOMIC REVIEW, SPECIAL ISSUE (2017), https://www.kansascityfed.org/documents/765/2017-Consolidation,%20Concentration,%20and%20Competition%20in%20the%20Food%20System.pdf.

[35] Tina Saitone and Richard Sexton, *supra* note 32.

[36] Stephen Ezell, *Biden's Assertion of Excessive Biopharma Industry Concentration Is a Flawed Rationale for a Flawed Policy,* ITIF (December 11, 2023), https://itif.org/publications/2023/12/11/biopharma-concentration-is-a-flawed-rationale-for-a-flawed-policy/.

[37] Robert Atkinson and Stephen Ezell, *Five Fatal Flaws in Rep. Katie Porter's Indictment of the U.S. Drug Industry*, ITIF (May 2021), https://itif.org/publications/2021/05/20/five-fatal-flaws-rep-katie-porters-indictment-us-drug-industry/.

[38] Ezell, *supra* note 36.

[39] Julie Carlson, *What's Past Is Prologue: Microsoft's Acquisition of Activision Blizzard Does Not Raise Foreclosure Concerns*, ITIF (October 24, 2022), https://itif.org/publications/2022/10/24/microsofts-acquisition-of-activision-blizzard-does-not-raise-foreclosure-concerns/.

[40] *Id.*

leading the world in GenAI innovation and research, and his home to 35 of the world's top 50 Artificial Intelligence [] companies" with "San Francisco and San Jose [] dominating this technological revolution, accounting for a quarter of all AI patents, conference papers, and companies globally."[41] What's more, there appears to be no indication that existing federal antitrust laws are any less sufficient to police this new technological revolution than they were for those of decades past, which contributed so much to successfully growing California's economy.

Additionally, even if amending the Cartwright Act to encompass unilateral conduct were a response to some limitations with respect to the existing legal framework, the example statutory language in the single-firm report raises significant structural issues by virtue of going well beyond the current contours of federal law. Under §2 of the Sherman Act, unilateral exclusionary conduct is unlawful only if a firm has either monopoly power, as for the "monopolization" offense, or both a dangerous probability of acquiring monopoly power and anticompetitive intent to do so, as with the "attempted monopolization" offense. However, in its example statutory language, the single-firm report expressly rejects this framework, stating that liability for unilateral exclusionary conduct can apply to a firm "regardless of whether it has or may achieve a market share above a threshold recognized under Section 2 of Sherman Act."[42] Instead, the example statutory language seems to create a standard that prohibits unilateral exclusionary conduct that maintains or creates market power,[43] which can obtain even for market shares below 50 but above 30 percent.[44]

There are several difficulties with this approach. Condemning unilateral conduct that merely creates or maintains market power will significantly increase the administrative costs borne by Californian taxpayers, whose courts will likely be faced with a deluge of antitrust litigation against firms that are not currently subject to unilateral conduct liability under federal standards. Increased administrative costs will also be imposed on firms not just due to a significantly greater number of companies having to engage in unilateral conduct compliance, but by increasing legal uncertainty: firms that enjoy durable monopoly power are far easier to identify than firms which may have some degree of transitory market power, making it less clear to whom the unilateral conduct rules will apply relative to the standards in §2 of the Sherman Act.

A market power threshold would also undoubtedly chill innovative behavior that benefits consumers. Market power that does not take the form of durable monopoly power very often falls well short of the point on the inverted-U curve where concentration is likely to harm innovation. Indeed, many studies in the business strategy literature suggested that healthy dynamic competition is optimized with approximately three equal sized firms, [45] each of whom may have some degree of market power that helps to facilitate innovation

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[41] Executive Department, State of California, Executive Order N-12-23, GSS_9534-1E-20230905164825 (ca.gov).

[42] Single-Firm Report at 18.

[43] *Id.* at 16 (defining anticompetitive exclusionary conduct as that which results in "increasing the defendant's market power").

[44] *See* Rebel Oil Co., Inc. v. Atlantic Richfield Co., 51 F.3d 1421, 1438 (9th Cir. 1995); *see also* M&M Medical Supplies & Serv., Inc. v. Pleasant Valley Hosp., Inc., 981 F.2d 160, 168 (4th Cir. 1992) (en banc).

[45] *See, e.g.*, JAGDISH SHETH, CAN USLAY & RAJENDRA SISODIA, THE GLOBAL RULE OF THREE: COMPETING WITH CONSCIOUS STRATEGY (2020); Adam Thierer, *The Rule Of Three: The Nature of Competition In The Digital Economy*, MERCATUS (July 2, 2012); Can Uslay, Z. Ayca Altintig, & Robert D. Windsor, *An Empirical Examination of the "Rule of Three": Strategy Implications for Top Management, Marketers, and Investors*, 74 J. OF MARKETING 20 (2010). Indeed, such findings are consistent with recent agency investigations concerning innovation. *See, e.g.,* Randy C. Chugh at al.,

competition. Rather than fostering this healthy and dynamic "competitive enthusiasm that the antitrust laws seek to promote,"[46] the example statutory language greatly risks stifling it by subjecting firms to a unilateral code of conduct properly suited to monopolistic markets where there are real indicia of market failure.

Unfortunately, the example statutory language in the single-firm report discounts these concerns about over-enforcement or "false positives" by expressly stating that "courts should bear in mind that the policy of California is that the risk of under-enforcement of the antitrust laws is greater than the risk of over-enforcement."[47] However, it is precisely the opposite approach has been taken by the Supreme Court, who has long recognized that false positives are "especially costly"[48] and in the case of unilateral conduct "counsel[] against an undue expansion" of antitrust liability."[49] Moreover, even if this greater concern for false positives were abandoned, at the very least error costs from false positives and false negatives should be weighted equally in a way that is broadly consistent with federal standards, as "an error cost bias in either direction represents a form of double counting that threatens to undermine sound enforcement goals."[50]

This considerable departure from the Sherman Act's unilateral conduct enforcement regime is likely to create tensions within the broader U.S. antitrust enforcement landscape. And, although it is true that Supreme Court in *California v. ARC Am. Corp.*[51] held that state antitrust laws can prohibit behavior that is not unlawful under federal standards, this is not a blanket constitutional protection. That is, state antitrust laws could be pre-empted by Congress, and indeed courts have in some cases pre-empted state antitrust laws if they are incompatible with federal standards.[52] Indeed, as distinct from the courts, Congressional pre-emption could also be used to address problems associated with state enforcement actions that go beyond accepted federal standards[53] and create a fragmented antitrust enforcement landscape.

EXCLUSIONARY CONDUCT STANDARDS

The single-firm report also presents a very different model with respect to the standards used to evaluate whether unilateral conduct is unlawful relative to those of federal law, which the report itself does not accurately describe. The single-firm report claims that under federal antitrust law unilateral exclusionary conduct is generally evaluated by a four-step rule of reason, where in step three a plaintiff is able to rebut a defendant's procompetitive justification by "proving that the procompetitive benefits could largely have been

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Economics at the Antitrust Division 2015–2016: Household Appliances, Oil Field Services, and Airport Slots, 49 REV. IND. ORGAN. 535, 546 (2016) (noting the Division's findings in the Haliburton/Baker Hughes that "only the Big Three are serious participants in this market because of the breadth of their product lines, their ability to integrate products and services, the quality of their reservoir data, and their capacity to conduct the necessary R&D" and describing how "persistent innovation leadership of the Big 3 is supported by their scale and scope').

[46] *See* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 755 (1984).

[47] Single-Firm Report at 15.

[48] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986).

[49] Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

[50] *See* Herbert J. Hovenkamp, *Antitrust Error Costs*, U. PENN. J. BUS. L. 293, 302 (2022).

[51] 490 U.S. 93, 102 (1989).

[52] *See* Alan Meese, *Antitrust Federalism, Preemption, and Judge-Made Law*, 133 HARV. L. REV. 2557, 2560 n.28 (2020).

[53] *Id.* at 2561–2565.

achieved by conduct that was less harmful to competition."[54] And yet it is telling that the single-firm report provides no citation for this step in the rule of reason. To be sure, while it cites *U.S. v. Microsoft* for the other steps, in that case the D.C. Circuit did not identify any such requirement of reasonably necessity.[55]

There is a reason why the rule of reason that is sometimes used for evaluating unilateral conduct differs in this respect from that used to assess the merits of concerted behavior under §1 of the Sherman Act, which can involve some inquiry into "less restrictive" alternatives.[56] As the Supreme Court made clear in *Verizon v. Trinko*, the antitrust laws do "not give judges *carte blanche* to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition."[57] And the intuition behind this is simple: it would be extremely difficult and costly for firms to evaluate whether there is a possible world where a procompetitive goal could be unilaterally achieved in a way more favorable to competitors. It is thus concerning that such a condition on efficiency defenses is incorporated into the example statutory language.[58]

The example statutory language would also go beyond federal antitrust law by making a rule of reason balancing test the default standard for evaluating unilateral exclusionary conduct. Indeed, the Sherman Act does not by its text provide any singular rule for evaluating what constitutes exclusionary conduct, and over time courts have come to articulate several different tests that are used commensurate with the conduct at issue.[59] Put simply, the forms of unilateral conduct engaged in by firms are varied and diverse, and conduct-specific rules are essential to ensure that legal tests are both administrable and avoid unnecessary error costs that can arise by, for example, applying too strict a rule to a relatively benign form of unilateral behavior.

For example, making the rule of reason a general standard would prove especially costly when it comes to evaluating incremental innovations in the form of product design changes, as balancing runs into difficulties when it comes to measuring the competitive tradeoffs between static harms and dynamic benefits.[60] Accordingly, the Ninth Circuit recognized that applying a balancing test to product design changes would not only dampen innovative behavior that benefits consumers, but also be practically unadministrable, as "[t]here are no criteria that courts can use to calculate the 'right' amount of innovation, which would maximize social

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[54] Single-Firm Report at 6.

[55] *See* United States v. Microsoft Corporation, 253 F.3d 34, 59 (D.C. Cir. 2001).

[56] Ohio v. American Express, 138 S. Ct. 2274, 2291 (2018).

[57] Trinko at Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP, 540 U.S. 398, 415-16 (2004).

[58] *Id.* at 17.

[59] *Compare* Brooke Group v. Brown & Williamson Tobacco, 509 U.S. 209 (1993) (two-pronged price cost and recoupment test) *with* Verizon Communications v. Law Offices of Curtis V. Trinko, 540 U.S. 398 (2004) (imposing a prior course of dealing requirement).

[60] *See* Joshua D. Wright, *Antitrust, Multi-Dimensional Competition, and Innovation: Do We Have An Antitrust-Relevant Theory of Competition Now?*, in REGULATING INNOVATION: COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY 240-41 (2011) (discussing how, while perhaps not impossible, the economic tools to measure tradeoffs between static and dynamic competition by examining technical rates of substitution are not yet available); *see also* Harold Demsetz, *The Intensity and Dimensionality of Competition*, in THE ECONOMICS OF THE BUSINESS FIRM: SEVEN CRITICAL COMMENTARIES 137, 144 (1995).

gains and minimize competitive injury."[61] Instead, the Ninth Circuit has applied a test that only condemns design changes as unlawful if there is no legitimate product improvement or product improvement.[62]

As distinct from this type of "predatory innovation," a rule of reason test is also plainly not well suited to evaluate the legality of refusals to deal, which often stimulate dynamic competition that risks being chilled by a balancing framework. As the Supreme Court explained in *Trinko*, not only does forcing firms to deal "lessen the incentive for the monopolist, the rival, or both to invest" but it "requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill suited."[63] For this reason, the Court required that refusals to deal only be found unlawful if there is some termination of a prior course of dealing, a requirement that the single-firm report appears to expressly disclaim in its proposed statutory language.[64]

Finally, and separately, exclusionary conduct claims must also satisfy causation standards which require the plaintiff to show that it's conduct results in the specified anticompetitive effect. Under federal antitrust law, the causation standard varies with the nature of the theory at issue: typically, courts ask whether monopolization would have occurred "but for" the anticompetitive conduct,[65] which limits false positives stemming from a "causal connection [that] is highly speculative."[66] However, for monopoly maintenance cases that involve the exclusion of potential competitors, a "reasonably capable" standard can apply.[67] But the single-firm report seems to generalize this lower *Microsoft*-esque "material risk"[68] causation standard for all forms of unilateral conduct, which opens the door not just to false positives, but increased administrative costs fueled by more litigation over speculative theories of harm.

RECOMMENDATIONS

For these reasons, ITIF has significant concerns about the reform proposals outlined in the Report and offers the following recommendations:

- **Reject The Hype Regarding Increased Concentration:** Concerns about increased concentration are not only overblown, but overlook that concentration is not the same as market power—let alone consumer harm. A careful and comprehensive analysis of claims regarding rising concentration in California both economy wide and on industry specific bases are necessary before enacting any far reaching antitrust reforms based on the premise that the existing regime has failed.
- **Reassess The Need For Competition Reform:** Over the past several decades, California has emerged as the global hub of innovation, driven by the dynamic and Schumpeterian competition where size and scale are a feature, not a bug, of a healthy competitive process. Rather than stagnate, this

[61] Allied Orthopedic v. Tyco, 592 F.3d 991, 998 (9th Cir. 2010).

[62] *Id.*

[63] Trinko at Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP, 540 U.S. 398, 408 (2004).

[64] Single-Firm Report at 17.

[65] Rambus Inc. v. FTC, 522 F.3d 456, 466 (D.C. Cir. 2008).

[66] Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 320 (3d Cir. 2007).

[67] U.S. v. Microsoft Corporation, 253 F.3d 34, 79 (D.C. Cir. 2001).

[68] Single-Firm Report at 16.

technological growth continues with AI, where California is again leading the world into a new future. All of this has occurred notwithstanding the lack of any Californian unilateral conduct regime, which raises the question as to whether antitrust reform is a soluition in search of a problem.

- **Keep the Cartwright Act Consistent With Federal Standards:** To the extent that the Commission wishes to expand the Cartwright Act to encompass unilateral exclusionary conduct, it should not go beyond existing federal standards as reflected in § 2 of the Sherman Act. The existing federal framework reflects over a century of judicial experience in shaping an antitrust regime that strikes a delicate balance between crafting administrable legal rules, not unduly chilling procompetitive behavior, and promoting robust antitrust enforcement.

CONCLUSION

As the old adage goes, if it's not broke, don't fix it. Simply put, there is no firm basis for concluding that California needs a unilateral conduct regime to complement federal law. The concentration report's claims on concentration in general, in the labor market, or in specific industries clearly falter when examined against a more wholistic view of the empirical evidence. As such, the findings of this report should not be a driver of any policy changes, but rather a baseline for continued study and analysis. At bottom, the doom and gloom narrative not only fails to hold up nationally, but poorly captures the dynamics of California's markets.

In fact, California is perhaps the greatest success story of the antitrust *status quo*. The unprecedented innovation that has come out of Silicon Valley over the past many decades and which continues today with the ongoing gales of creative destruction in areas like artificial intelligence, where California is again leading the world, strongly suggests that antitrust reforms are a solution in search of a problem. Rather than stay the course, the proposed statutory langauge in the single-firm report would, relative to existing federal law, apply stricter unilateral conduct standards to a broader swath of firms that lack monopoly power. By taking such an approach, California would in effect ratify the post-war competition law paradigm adopted by Europe, which has fallen behind on innovation and lacks any world class digital firms of its own.

As such, if implemented the example statutory language in the single-firm report risks deviating from the current antitrust framework in a way that puts at risk California's future as the world's leading innovation hub. Having courts engage in the highly impractical exercise of weighing the harms and benefits of behavior like product improvements and refusals to deal undertaken by firms that lack any kind of monopoly power will result in increased error and administrative costs that are likely to far ouweigh any benefits. To the extent it wishes to include a state unilateral conduct regime in the Cartwright Act, California should thus closely adhere to federal antitrust standards, including critical Ninth Circuit cases like *Tyco v. Allied Orthopedic*.

Thank you for your consideration.

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