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Competition law and policy of Japan

BY TOSHIAKI TAKIGAWA*

I. INTRODUCTION

A. Overview

Competition law in Japan (the Antimonopoly Act or AMA)[1] already has a history of sixty-two years. It was originally initiated under the heavy influence of U.S. antitrust laws, but at the same time, it was equipped with fairness-oriented regulations, that is, unfair trade practice regulations. The resulting mix of orthodox antitrust principles and fairness-oriented regulations has complicated the application and enforcement of the Antimonopoly Act. As to sanctions, the U.S.-influenced criminal penalties were later mixed with European-influenced surcharges. This mix contributed to the sometimes inconsistent ways of enforcing the Antimonopoly Act.

The Fair Trade Commission of Japan (JFTC),[2] an independent competition agency, has greatly contributed to developing and

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[1] Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade, Act No. 54 (1947, revised 2005) [hereinafter Antimonopoly Act or AMA]. An English translation is available at http://www.jftc.go.jp/e-page/legislation/ama/amended_ama.pdf.

[2] *See* JFTC, http://www.jftc.go.jp/e-page/aboutjftc/list200906.html (last visited June 28, 2009).

strengthening the Antimonopoly Act and its enforcement, particularly through rejection of an industrial policy (or public interest) interpretation of the AMA. However the JFTC has, at the same time, often stuck to an inflexible interpretation of the AMA, forsaking rule of reason analyses. The JFTC can also be criticized for making too much use of unfair trade practice regulations, sacrificing economics-based competition principles. However, in recent years, courts have increasingly come to play a role as important as that of the JFTC by introducing new ideas for the application of the AMA, including private action suits as well as those for nullification of JFTC decisions.

This article aims to systematically analyze the current status of the AMA and its enforcement, contrasting them with the U.S. and European Community (EC) competition laws, and then to make suggestions for future improvements.

B. History of the Antimonopoly Act

The Antimonopoly Act together with its enforcement agency, the JFTC, was inaugurated after World War II in 1947 under the strong leadership of the U.S. Occupation Forces. The AMA, therefore, was largely modeled along the lines of U.S. antitrust laws. However, uniquely Japanese characteristics, especially the concept of unfair trade practices, were added to the AMA making its clauses more complicated than the U.S. Sherman Act. Moreover, very detailed definitions were originally set up for key AMA clauses—“unreasonable restraint of trade” and “unfair trade practices”—making it difficult to improve regulations through application to cases.

After the end of the U.S. occupation, the Japanese Diet amended the AMA in 1949 and 1953. These two amendments abolished excessively rigorous prohibitions—in particular, the almost complete prohibition of cooperative conduct and pre-approval system of mergers; however, the main contents of the AMA were not weakened.[3]

After the initial active enforcement of the AMA in the 1940s, the JFTC greatly reduced its enforcement of the AMA, as it was overwhelmed by the industrial policies of the Ministry of Industry and

[3] For detailed early history of the Antimonopoly Act, see Hiroshi I. Iyori & Akinori Uesugi, THE ANTIMONOPOLY LAWS AND POLICIES OF JAPAN 1–40 (1994).

Trade (MITI). However, in the latter half of the 1970s, the Japanese government recognized the importance of enforcement of the AMA to control inflation. Thus in 1977 the Diet strengthened the AMA by introducing administrative surcharges against price cartels. Then, during the 1980s, trade conflict with United States deepened, and through the U.S.-Japan Structural Impediment Initiative,[4] the Japanese government pledged to strengthen the AMA and its enforcement with the objective of opening up Japanese markets. The result was the strengthening of criminal penalties and heavy condemnation of bid-rigging.

During the 1990s, the Japanese government placed greater emphasis on competition policy and introduced procompetitive regulatory reforms to revitalize the Japanese economy, which had been stagnant after the 1990 collapse of Japan's rapid economic growth. As a result of the most recent AMA amendment, in 2005, surcharges were augmented, a leniency system was introduced, and the investigative powers of the JFTC were strengthened.

C. *Structure of the Antimonopoly Act*

The AMA has four pillars that deal with four types of anticompetitive conduct: (1) unreasonable restraint of trade, (2) unfair trade practices, (3) mergers and stock acquisitions, and (4) monopolization. (See tables 1 and 2.) Among these, the first, third, and fourth pillars are largely equivalent to the corresponding statutes in the U.S. antitrust laws. But, the second pillar—unfair trade practices—is a uniquely Japanese concept (now shared with some other Asian countries).

Unfair trade practices overlap with monopolization, as well as with aspects of unreasonable restraints of trade. Moreover, the regulation of unfair trade practices covers policy areas usually not considered the domain of competition laws. These are the direct protection of consumers and of small and medium-sized enterprises. As a result of such widespread coverage, the AMA clause against unfair trade

[4] *See* Joint Report of U.S.-Japan Working Group on Structural Impediments Initiative 2 (June 28, 1990) [herinafter Joint Report]; [U.S. Trade Rep., National Trade Estimate Report of Foreign Trade Barriers 107 (1990).

practices has often been criticized by businesses and academics for its unclear standards for illegal conduct.

Table 1
Four Pillars of the AMA Clauses

	AMA Articles	*Requirements for Identifying Illegality*	*Targeted Business Conduct*
Unreasonable Restraint of Trade	• Art. 3 (latter half) • Art. 2 (6)	• Mutual restriction • Substantial restraint of competition	• Horizontal agreements
Unfair Trade Practices	• Art. 19 • Art. 2 (9)	• Discrimination, restriction, obstruction, abuse, etc. • Unjustness • Impediment to fair competition	• Vertical agreements (restraints) • Part of horizontal horizontal • Exclusionary conduct • Other unfair conduct
Mergers and Stock Acquisitions	• Art. 10 • Art. 15	• Market concentration causing substantial restraint of competition	• Mergers • Stock acquisitions
Monopolization	• Art. 3 (former half) • Art. 2 (5)	• Exclusion or control • Substantial restraint of competition	• Exclusionary conduct • Control of other companies

Table 2
Categories of Anticompetitive Conduct and Applicable AMA Clauses

Anticompetitive conduct	*Applicable AMA clauses*
Horizontal agreements	• Unreasonable restraint of trade • "Control" part of monopolization • Unfair trade practices
Vertical agreements (restraints)	• Unfair trade practices
Mergers and stock acquisitions	• Clauses for mergers and stock acquisitions
Exclusionary conduct	• Monopolization • Unfair trade practices
Other unfair conduct	• Unfair trade practices

II. OBJECTIVE OF COMPETITION LAW AND AGENCY DESIGN

A. Objective of the Antimonopoly Act: consumer surplus or total surplus?

An almost universally regarded objective of world competition laws is consumer welfare. Nevertheless, what makes up "consumer welfare" is somewhat controversial: Is it "consumer surplus" or "total surplus" (consumer surplus plus producer surplus)? Article 1 of the AMA is ambiguous on this point. The description lists both consumer surplus ("attainment of general consumer interests") and total surplus ("promotion of national income" and "development of national economy") as objectives without setting priorities. In the enforcement of the AMA by the JFTC and courts, the objectives of the AMA have rarely been discussed because the JFTC and courts have usually found business conduct illegal when the conduct effectively restrained competition as stipulated in each of the AMA clauses: "substantial restraint of competition" for an unreasonable restraint of trade, monopolization, and mergers; "danger to impede fair competition" for unfair trade practices.

Until very recently, defense arguments rationalizing restraints of competition have been admitted only for safety reasons. Nevertheless, in recent decisions of both the JFTC and the courts, as well as in the JFTC guidelines, a defense of efficiency has been admitted. In the most recent example, the JFTC's Business Combination Guidelines allow for a defense of efficiency, at least as far as the achieved efficiency benefits consumers.[5] The Business Combination Guidelines suggest that the JFTC considers consumer surplus as the prime objective of the AMA, although the JFTC usually concentrates on scrutinizing effects that restrict competition.

In cases concerning unfair trade practices, the courts in recent decisions have started to allow a defense based on efficiency. See part V.E. below. Nevertheless, such decisions have not explained how the effects of restricting competition and those achieving efficiency are balanced. Courts, therefore, have not taken a stand regarding a choice of either consumer surplus or total surplus.

B. Controversy on "public interest"

The AMA stipulates that "unreasonable restraint of trade" and "monopolization" are illegal when they are against the "public interest."[6] This sweeping expression portends the risk of subordinating competition policy to public or industrial policies. To shield against this risk, the JFTC has interpreted the expression of "public interest" as ornamental, preservation of competition being equivalent to public interest.

However, in the *Oil Cartel* decision,[7] the Supreme Court stated that "public interest" may, in "exceptional circumstances," override the direct objective of preservation of free competition under the AMA, from the viewpoint of the ultimate objective of consumer

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5 JFTC, Guidelines to Application of the Antimonopoly Act concerning Review of Business Combination § IV.2 (7) (revised, Mar. 28, 2007) [hereinafter Business Combination Guidelines], *available at* http://www.jftc.go.jp/e-page/legislation/ama/RevisedMergerGuidelines.pdf.

6 *See* AMA, arts. 2 (5) & (6).

7 Oil Cartel, 38 (4) Keishu 1287, 1311 (Sup. Ct., Feb. 24, 1984).

interests and development of the national economy. This case dealt with an oil price cartel arising under conditions of an economic crisis, caused by a steep rise in the price of imported oil resulting from OPEC price increases. The Supreme Court decision, although it did not exonerate the price cartel, established the concept that public interest may be considered to exonerate restraints of competition in exceptional circumstances.

Since the decision admitted defenses based on public interest only in exceptional circumstances, normal defenses for violations, such as safety and other efficiencies, should not be considered as "public interest," but should be considered in the interpretations of "unreasonable restraint of trade," "monopolization" or "unfair trade practices." However, some confusion about this point exists, and some lower court decisions have resorted to the public interest clause to allow the safety defense.[8]

C. *Fair Trade Commission of Japan*

The AMA is predominantly enforced by the JFTC. Private actions, without the involvement of the JFTC, may be filed, and their number has been increasing, but they still represent only a small portion of cases involving the AMA.

1. CHAIRMAN, COMMISSIONERS, AND SECRETARIAT The JFTC is composed of commissioners and the Secretariat. The chairman and four additional commissioners are authorized to act independently from the government, although the JFTC, as a governmental organization, comes under the Cabinet Office.[9]

Commissioners (including the chairman) are appointed by the Prime Minister. Legally, the chairman and commissioners have equal voting power, except at the time of an equality of votes. In practice, the chairman has been considered the chief executive; the other com-

[8] *See* Air Soft Gun, 44 SHINKETSUSHU 635, 683 (Tokyo Reg. Ct., Apr. 9, 1997) (An industry association's code of conduct concerning safety, even if it amonts to "substantial restraint of competition" may be found to be legal, as not against "public interest.")

[9] *See* AMA, arts. 27, 28.

missioners have only rarely made public an opinion opposed to that of the chairman. The chairman is a political appointee and has usually, as is true of the current chairman, been selected from among former top directors of influential government ministries, predominantly the Ministry of Finance.

In contrast to the U.S. Federal Trade Commission, where commissioners are selected from among antitrust lawyers and economists, the JFTC commissioners have been predominantly former government officials without specialized experience in competition law or economics. They learn on the job during their five years' of tenure with possible reappointment. Currently, among the five commissioners, two have prior experience in competition law or economics: One is a former director-general of the JFTC Secretariat; another is a former Tokyo University professor of economics, specializing in industrial organization. To augment the competency level of commissioners, it is desirable that the majority of commissioners be selected from among competent lawyers or economists with experience in competition law and policy.

The Secretariat is composed of the Director-General, three General-Divisions comprised of fifteen sections, and five local offices. Staff members have mostly been recruited from among university graduates with an undergraduate degree in law or economics. A few of them have had experience as attorneys, or have Ph.D.s in economics. The JFTC has pledged to increase the number of such professionals among its recruits. Indeed, the number of attorneys recruited from the prosecutor's office or private law firms has been increasing, particularly for positions in charge of decisions, suits, and criminal investigations.

2. REMEDY ORDERS, HEARINGS, DECISIONS, AND SANCTIONS

a. Remedy Orders, Hearings, and Decisions When the JFTC has determined conduct to be illegal under the AMA, it issues "remedy orders" (or cease and desist orders) to the violating companies.[10] The remedies may also include behavioral orders and structural remedies.

[10] *See* AMA, art. 49. The JFTC's translation of the AMA uses, as the translation of the original Japanese *Haijo Sochi Meirei,* "cease and desist order" rather than "remedy order." Nevertheless, "remedy order" may be the more accurate translation, since *Haijo Sochi Meirei* includes not only "cease and desist orders" but also orders to perform specific conduct. *See, e.g.*, AMA, art. 9.

Before the 2005 revision of the AMA (implemented in January 2006), remedy orders had to be preceded by JFTC "decisions." The decisions were of three kinds: (1) recommendation decision, in which the JFTC first issues a recommendation to an allegedly violating company, demanding rectification of the illegal situation, and when the company has accepted the recommendation, the recommendation becomes a decision[11]; (2) hearing decision, in which the hearing examiners conduct a court-like adjudication and present the resulting decision (proposed decision) to the Commission, which adopts, rejects, or amends the proposed decision; and (3) consent decision, in which a defendant company and the JFTC negotiate and arrive at consented to measures without any admission of illegality on the side of the defendant company.

Recommendation, recommendation decision and consent decision were all abolished by the 2005 revision of the AMA. In place of issuing a recommendation, the JFTC will always first issue a remedy order to a company that the JFTC has found to be in violation of the AMA. Only when the ordered company opposes the order does the JFTC initiate a hearing that will lead to a hearing decision.[12]

This procedural change aims at speeding up the conclusion of cases (surcharge cases, in particular). However, commentators have criticized the change as lacking in due process because hearings are initiated only after the JFTC has already issued remedy orders; therefore, the JFTC is not likely to render hearing decisions that override its own remedy orders. The AMA Study Group was established in the Cabinet Office with the objective of improving the 2005 AMA revisions. The Study Group, in its 2007 report[13] (the Cabinet Office Report), basically supported this criticism and recommended the reversal (without recommending a specific timetable) of the decision

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[11] If the JFTC considered the issuance of a recommendation unwarranted, it often issued unofficial "warnings" to suspect companies.

[12] *See* AMA, art. 49(6).

[13] Advisory Panel on Basic Issues Regarding the Anti-Monopoly Act, Report on Basic Issues Regarding the Anti-Monopoly Act (June 26, 2007) [hereinafter Cabinet Office Report], *available at* http://www8.cao.go.jp/chosei/dokkin/kaisaijokyo/finalreport/finalreport_en.pdf.

procedure to the pre-2005 system, together with necessary measures to precipitate the conclusion of decisions. The JFTC has pledged to introduce a bill to amend the AMA regarding JFTC hearings and decisions before the end of fiscal year 2009, in order to largely incorporate the opinion of the Study Group.

b. Surcharges and Criminal Penalties Penalties against companies or individuals found to be in violation of the AMA consist of (1) administrative surcharges and (2) criminal penalties.

Surcharges are levied only on companies (not individuals) engaging in price cartels or similar serious violations affecting prices (among violators of the "unreasonable restraint of trade" and the "control" aspect of monopolization).[14] Surcharges are automatically levied, without any discretion by the JFTC. The amount of surcharge is calculated for manufacturers as ten percent (four percent for small and medium-sized companies) of the amount of sales of the product involved in the violation.

The Cabinet Office Report recommended that surcharges be extended to violations of article 2(5), the monopolization clause, and selected practices in violation of article 2(9), the unfair trade practices clause. In response, the JFTC and government announced a bill to partially amend the AMA.[15] The bill contains provisions to extend surcharges to violations of (1) the monopolization clause; and (2) the unfair trade practices clause regarding (i) unduly low pricing and discriminatory pricing, (ii) concerted refusal to deal, (iii) resale price

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14 *See* AMA, art. 7(2).

15 Press Release, JFTC, Submission of the Antimonopoly Act Amendment Bill to the Diet (Mar. 11, 2008), *available at* http://www.jftc.go.jp/e-page/pressrelease/2008/march/080311.pdf. The bill also includes a provision to increase by fifty percent the amount of the surcharge on companies that played leading roles in hard-core cartels and bid-riggings. This bill is expected to be partially changed by government, in order to accommodate opinions from the opposing political party and to be deliberated before the Parliament in 2009. *The Bill to Amend the Antimonopoly Act is Scheduled to be Abolished and the Government and the Ruling Party are Planning to Put Forward the New Bill Next Spring*, NIHON KEIZAI SHINBUN (The Nikkei Newspaper), Dec. 14, 2008. This new bill, which is basically the same as the old bill, passed by the Diet and became law on June 3, 2009.

maintenance, (iv) abuse of superior bargaining position, and (v) misrepresentations in violation of the Act against Unjustifiable Premiums and Misleading Representations.

Among these extensions of surcharges, the extension to the monopolization clause, as well as the extension to the unfair trade practices clause regarding unduly low pricing, discriminatory pricing, and abuse of superior bargaining position would run the risk of deterring vigorous competition because violations of monopolization and the specified unfair trade practices are hard to distinguish from legitimate competition.[16] See parts V and VII below.

To alleviate the overdeterrent effects of surcharges, I believe it would become imperative to abolish the automatic levying of surcharges and alter the surcharge system to reflect the EC model[17]: allowing the JFTC to exercise discretion based on a guideline about whether to levy surcharges or not, as well as the amount of surcharges.

Criminal penalties may be levied on violators (companies and individuals) of the unreasonable restraint of trade (mostly horizontal cartels) and monopolization provisions.[18] In practice, criminal penalties have never been levied on violators of the monopolization clause, but have been levied on a selected number of violators of the unreasonable restraint of trade clause regarding price cartels or bid-riggings.

To resort to criminal penalties, the JFTC has to file charges with the Prosecutor's Office.[19] The JFTC has been very selective in choosing cases to be charged with criminal penalties sought. Since 1991, when the JFTC invigorated criminal charges, less than an average of one case annually has been charged. Criminal penalties can be levied on companies and individuals (executives or employees of the compa-

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[16] Extension of the surcharge to resale price maintenance and misrepresentation is commendable because these violations are clearly anticompetitive and harmful to consumer welfare.

[17] *See* European Commission, Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No. 1/2003, 2006 O. J. (C 210) 2–5.

[18] *See* AMA, art. 92.

[19] *See* AMA, art. 96(1).

nies), but all such individuals have so far been given suspended sentences by the courts; none has been imprisoned.

D. The role of the courts—nullification suits

Courts are involved in AMA cases through two routes: (1) suits seeking nullification of JFTC decisions and (2) private actions. The first route is available when companies found to be engaged in illegal activities by a JFTC decision bring a suit to a court seeking nullification of the JFTC decision. These decision nullification suits ought to be brought to Tokyo High Court,[20] since JFTC hearing decisions are treated as being equivalent to regional court decisions. As a further limitation, the Tokyo High Court is obliged to comply with the JFTC's findings of facts as far as the findings are based on "substantial evidence."[21] The number of decision nullification suits has been much smaller than those lodged in the United States. This is mainly because hearing decisions have been few compared to recommendation decisions, for which nullification suits are not available on the grounds that companies have voluntarily accepted JFTC recommendations.

E. The role of the courts—private actions

The second route in which courts can be involved is through private actions. In private actions, citizens or companies can bring suits related to AMA violations directly to regional courts without the involvement of the JFTC. In the United States, the large majority of antitrust cases have been initiated through private actions. By contrast to the United States, the number of private action cases in Japan has been very small. However, the number has been constantly increasing, and court decisions with noteworthy opinions have come out of private actions.

1. INJUNCTION SUITS Citizens or companies can initiate private actions seeking injunctions against anticompetitive conduct by which they have been victimized. Such injunction suits regarding AMA violations were prohibited until 2000, at which time private injunction suits were legalized. Nevertheless, the legalization is limited to

[20] *See* AMA, art. 85(1).

[21] *See* AMA, art. 80.

violations of the unfair trade practices clause.[22] This limitation aims to reduce the number of private suits. As a further limitation, plaintiffs are obligated to prove that they sustained "extreme damage."[23]

The number of private injunction suits has remained small (on average, about three cases annually), and no injunction has yet been sustained by the courts. Nevertheless, injunction suits have contributed to eliciting from the courts important opinions on the AMA, opinions which have often been at odds with the opinions expressed in JFTC decisions.

2. DAMAGE RECOVERY SUITS It has always been possible for private citizens and companies to bring suits seeking recovery of damages caused by conduct that is in violation of the AMA. Damage recovery suits may be filed based on either article 26 of the AMA or article 709 of the Civil Code. Damage recovery suits may be filed as purely private suits, but most damage recovery suits have been filed after the JFTC has issued decisions finding AMA violations. Only single damages are recoverable; the treble damage system practiced in the United States does not exist in Japan.

The number of damage recovery suits regarding AMA violations has remained very small compared to the large number in the United States, where not only the treble damage system but also class actions are available to plaintiffs; both are unavailable in Japan. Moreover, until 1998, courts demanded that plaintiffs present rigorous proof not only on damage causation but also on the precise amount of damages. Effectively no plaintiffs won in damage recovery suits.

However, in 1998, the revision in the Code of Civil Procedure made it possible for judges to calculate the appropriate amount of damages taking into account the arguments of the plaintiffs and defendants.[24] After this code change, several decisions resulted in which plaintiffs (citizens protesting against bid rigging, in particular) recovered considerable sums as damages.

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22 *See* AMA, art. 24.

23 *Id*.

24 *See* Minji Sosho Ho [Code of Civil Procedure], art. 248, *available at* http://www.cas.go.jp/jp/seisaku/hourei/data/ccp.pdf.

3. DELIBERATION FOR LIMITED CLASS ACTIONS The main reason for the scarcity of private suits in Japan, compared with the large number in the United States, is the unavailability of class actions. Class actions are a form of aggregated litigation in which one or more named plaintiffs represent the interests of all persons similarly affected.[25] Without class actions, private actions in respect to competition laws are destined to remain few. This is because, in the usual competition law violations, victims are numerous but the amount of damage incurred by each victim is small; thus there is little incentive for litigation. Class actions, therefore, are necessary to enable the aggregation of numerous victims. On the other hand, in the United States, some commentators have criticized class actions for inducing excessive solicitation of suits by attorneys.

In Japan, class actions have never been introduced into the general civil suit system. However, a near surrogate for a class action was instituted in 2008. This was limited to violations of the Consumer Contract Act,[26] legislation to protect consumers from abusive contract terms. This system was extended in 2008, within the framework of the Consumer Contract Act, to violations of the AMA, although the targeted violations are currently limited to those of the Act Against Unjustifiable Premiums and Misleading Representations, legislation related to unfair trade practices under the auspices of the JFTC.[27]

Class actions under the Consumer Contract Act are available only to the limited number of consumer associations approved by the national government. A more grave limitation is that class actions are allowed only to seek injunctions or cease-and-desist orders; damage recovery suits are not allowed.

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[25] For an explanation of class actions in the United States and EC, see Spencer W. Waller, *Toward a Constructive Public-Private Partnership to Enforce Competition Law*, 29 World Competition 367, 372–75 (2006).

[26] *See* Shohisha Keiyaku Ho [Consumer Contract Act], amended in 2008, art. 13, *available at* http://www.cas.go.jp/jp/seisaku/hourei/data/CCA.pdf .

[27] Press Release, JFTC, Enactment of a Law for the Partial Amendment to the Consumer Contract Act (Apr. 25, 2008), *available at* http://www.jftc.go.jp/e-page/pressreleases/2008/April/080425.pdf. The newly amended Consumer Contract Act was implemented on April 1, 2009.

The new aggregate litigation system, implemented in April 2009, is very limited by nature, but it is expected to be extended in the future to violations of the AMA. However, it is unsound thinking not to allow damage recoveries in class action suits. The basic aim of class actions is to enable the aggregation of small amounts of damages. In future deliberations, an aggregate litigation system under the AMA should be introduced to allow the recovery of damages.

F. *Suggestions for improvement*

- The objectives of the AMA affect the outcomes of AMA applications regarding business conduct. It is desirable that the JFTC and the courts make clear that the objective of the AMA is consumer surplus.
- It is desirable that the majority of commissioners be selected from among competent lawyers or economists with experience in competition law and policy.
- Surcharges should not be extended to violations of monopolization and unfair trade practices (regarding unduly low pricing, discriminatory pricing, and abuse of superior bargaining position). In cases in which such an extension was put into effect, the surcharge system should be changed to give discretion to the JFTC to decide on both the necessity for a surcharge and the amount.
- The limited class action should be extended to encompass not only injunction suits but also damage recovery suits.

III. RELATIONSHIP WITH GOVERNMENT REGULATIONS AND EXEMPTIONS

A. *AMA application to national and local governments*

Enactments adopted by national and local governments may not be condemned as violations of the AMA. This is a common worldwide limitation of competition laws, with some important exceptions being found in the EC and in the new Chinese competition laws.

Although government enactments may not be found to be in violation of the AMA, conduct by national and local governments is not, by itself, exempt from the AMA. Clauses in the AMA regulate conduct by "entrepreneurs" (a better translation would be "business entities"), which are defined as persons engaging in "commercial, industrial, financial or any other businesses."[28] Court decisions have expressed the opinion that governmental agencies can be treated as "entrepreneurs" when they operate in competition with private companies. The Supreme Court in its *Tokyo Municipal Slaughter House*[29] decision opined that "entrepreneurs" are identified, without regard to their legal status, whenever they engage in economic activities, which consist of repeatedly and consistently supplying economic goods in exchange for revenue.

Not only local governments but also the national government may be found in violation of the AMA. The Osaka High Court's *New Year's Greeting Post Card*[30] decision (a private action case) concerned a complaint from a maker of anniversary postcards against the Post Ministry that sold low-priced anniversary postcards. The High Court opined that the provision of postcards is not a national monopoly, although the provision of official postal cards is the inherent domain of the Post Ministry, and when the Post Ministry sells value-added postal cards (such as anniversary cards), it competes with private companies; therefore, the AMA is applicable to the Post Ministry in this case.

B. Application of the AMA to regulated industries

The AMA is applicable to regulated industries unless they are exempted from the AMA by law (including by the AMA itself). See part III.D below. In the JFTC *NTT East*[31] decision, hearing examiners (and consequently the JFTC) did not accept the defendant's argument that a telecommunications company regulated by telecommunications legislation may not be found in violation of the AMA. The JFTC based its denial on the fact that conduct in conformity with the telecom legislation is not necessarily in conformity with the AMA.[32]

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[28] *See* AMA, art. 2(1).

[29] 43 (12) MINSHU 2078, 2083 (Sup. Ct., Dec. 14, 1999).

[30] 1548 HANREIJIHO 63 (Osaka High Ct., Oct. 14, 1994).

[31] 53 SHINKETSUSHU 776 (FTC, Mar. 26, 2007). This decision was appealed to the Tokyo High Court for nullification and is now under deliberation.

[32] *Id.* at 812.

Nevertheless, conduct compelled by governmental regulations may not be found in violation of the AMA. Otherwise, companies would be at a loss about which violations to choose. The JFTC decision in *Osaka Bus Association*[33] concerned how to distinguish actual compulsion from mere approval or recommendation. In this case, under the Road Transportation Act, bus operators were obligated to get the approval of the Transportation Minister before they changed their bus fares. However, in the actual competitive market, the level of bus fares had been considerably lower than that of the approved fares. The Osaka Bus Association, an organization of bus operators, agreed not to operate chartered buses for fares lower than the approved rates. The JFTC condemned this agreement as an illegal cartel.

In the hearing proceeding, the Osaka Bus Association argued, among other things, that (1) the AMA is not applicable to sectors where the Road Transportation Act denies free competition; and (2) the JFTC is not allowed to intervene in conduct found legitimate and compelled under specific legislation. The JFTC in its decision rejected these arguments, noting that the Road Transportation Act does not cover the whole competitive order, and therefore the Act's fare approval system does not preclude the application of the AMA.[34]

Nevertheless, the *Osaka Bus Association* decision also noted that when those price agreements aimed to prevent prices which were prohibited with penalties available under laws other than the AMA, such price agreements do not ordinarily constitute "substantial restraint of competition" stipulated by articles 2 (6) and 8 (1) of the AMA.[35] However, the decision added, in specific circumstances, the JFTC may issue remedy orders against those price cartels that operate to prevent prices prohibited by law. Such specific circumstances include situations where, in actual competition, transactions at prices prohibited by laws other than the AMA are openly conducted.[36] In this case, such specific circumstances were not proven by the JFTC;

[33] 42 SHINKETSUSHU 5 (FTC, July 10, 1995).

[34] *Id.* at 51.

[35] *Id.* at 57.

[36] *Id.* at 61.

therefore, the hearing examiners found no evidence of illegality by the price cartel. This decision shows that the JFTC has very narrow circumstances under which compulsion by law is found to exempt activities from application of the AMA.

C. *Administrative guidance and the AMA*

The *Osaka Bus Association* decision and the similar *NTT East* decision imply that the JFTC sees exemptions from the provisions of the AMA only in cases where the anticompetitive conduct is compelled under penalty of law. Therefore, administrative guidance, which by nature is lacking in penalties against nonobservance, may not exonerate violations of the AMA. This effect is expressed in the JFTC Guidelines on Administrative Guidance.[37]

Nevertheless, as mentioned in part II.B above, in exceptional circumstances, price cartels in observance of legal administrative guidance may be found not in violation the AMA on grounds that such a price cartel is not against the "public interest."[38]

D. *Exemptions*

In limited cases, clauses in the AMA or other laws exempt certain conduct from application of the AMA. Such exemptions, mostly instituted for industrial policy purposes, used to be numerous and had robbed the AMA of much of its effectiveness. Exemptions from the AMA were criticized by the U.S. government in the U.S.-Japan Structural Impediment Initiative.[39] In the 1990s, the Japanese government radically reduced the number of AMA exemptions. Abolished exemptions included those related to natural monopolies (rail, electricity, etc.) and an exemption for depression cartels.

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37 JFTC, Guidelines Concerning Administrative Guidance under the Antimonopoly Act §1 (1) (June 30, 1994), *available at* http://www.jftc.go.jp/e-page/legislation/ama/administrative.pdf ("Without exemption clauses, private conduct induced by administrative guidance is subject to AMA application, when the conduct fulfils the conditions for illegality under the AMA.").

38 Oil Cartel, 38 (4) KEISHU 1287, 1311 (Sup. Ct., Feb. 24, 1894).

39 *See* Joint Report, *supra* note 4.

Current exemptions are composed of twenty-one items in fifteen legislative provisions. Most exemptions are price cartels and include insurance, sea transport, and airfare rate cartels. These exempted cartels have shielded their industries from competition and so retarded efficiency. The large majority of the exemptions are based on legislation other than that of the AMA, such as the Sea Transport Act and the Air Transport Act. The JFTC has been advocating the abolition of some of these exemptions. See part III.E below.

Of the three exemption articles contained in the AMA, article 21 stipulates exemption for exercises of intellectual property (IP) rights. The JFTC has limited the effects of this exemption article by interpreting that exemption as not applicable to those exercises of IP rights that "deviate from or run counter to the purposes of the intellectual property system."[40]

Article 22 of the AMA stipulates a limited exemption for cooperative associations established for mutual help among small-scale business entities or consumers. Article 23 stipulates a limited exemption from the prohibition of resale price maintenance. See part V.C below.

E. Advocacy role of JFTC

In addition to enforcement of the AMA, the JFTC, as an agency in charge of competition policy, has advocated against anticompetitive enactments and for the abolition of anticompetitive laws and regulations. Such an advocacy role is not stipulated in the AMA, but has been approved by the government as a proper role for the JFTC.

The JFTC has conducted its advocacy role through (1) communicating its opinions to ministries envisaging new legislation and (2) publishing reports of various study groups (under the auspices of the JFTC) on competition policy in regulated or exempted sectors. This advocacy role, although it is useful, has limitations in that ministries are not obliged to adopt JFTC opinions. To augment the effectiveness

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[40] JFTC, Guidelines for the Use of Intellectual Property under the Antimonopoly Act § 2.1 (Sept. 28, 2007), *available at* http://www.jftc.go.jp/e-page/pressreleases/2007/September/070928_IP_Guideline.pdf [hereinafter JFTC IP Guidelines].

of its advocacy, the JFTC needs to appeal directly to the public, particularly by putting its relevant opinions on its Web site. In this regard, publishing (and recruiting public comments on) study group reports on the JFTC Web site has proved to be effective in raising public awareness. As a recent example, in October 2007, the JFTC recruited public comments on a study group report, and then, in December 2007, published the report advocating the abolition of the exemption of international air transport[41] from the AMA.

F. Suggestions for improvement

- Exemptions from the application of the AMA have been greatly reduced, but need to be further reduced.
- It is desirable that the JFTC increase its appeals to the general public to increase the effectiveness of its advocacy role for eliminating anticompetitive enactments.

IV. HORIZONTAL AGREEMENTS

A. Price cartels, refusals to deal, and market power standard

1. MARKET POWER STANDARD AND THE NEED FOR DELINEATION OF THE MARKET Horizontal agreements—agreements among competitors—are regulated by AMA articles 3 and 2(6). Article 3 (the latter half) prohibits "unreasonable restraint of trade," which is defined by article 2(6) as "business activities, by which any entrepreneur, by contract [or] agreement . . . in concert with other entrepreneurs, . . . fix, maintain, or increase prices, or . . . limit production, . . . , thereby causing . . . substantial restraint of competition in any particular field of trade."

"Substantial restraint of competition" is the most important standard to identify illegality under the AMA. The AMA clauses for monopolization, article 2(5), and mergers, articles 10 and 15, also use this standard. "Substantial restraint of competition" has been interpreted by the courts and the JFTC as substantial market power—power to raise prices and affect other market conditions substantially

[41] *See* Press Release, JFTC, *available at* http://www.jftc.go.jp/pressrelease/07.december/07120501.html (Japanese version only).

away from a competitive stage.[42] This is basically the same market power concept adopted in the U.S. Horizontal Merger Guidelines.[43]

Adoption of a market power standard for identifying illegal agreements has led to a legal situation in which all agreements, including price cartels, are found *not* to be illegal unless they are found to create market power. This means that price cartels are *not* treated as per se illegal; the JFTC has been obliged to scrutinize horizontal agreements, including price cartels, the same way it scrutinizes mergers, delineating relevant markets and calculating market share.

2. THE "ILLEGAL IN PRINCIPLE" STANDARD FOR PRICE CARTELS

Adoption of a market power standard, resulting in the lack of per se illegality, has given the JFTC the burdensome task of delineating relevant markets and calculating the combined market shares of cartel participants. To circumvent this burden, the JFTC has been identifying a relevant market for a price agreement or price cartel as the product for which cartel participants aim to raise the price. For example, when tofu merchants engaged in a price cartel, the relevant product market was the tofu product, and the relevant geographical market the area where cartel participants are located. This reasoning is allowed on the grounds that the cartel participants' intent to raise the price signifies their market power in respect of the targeted product.

This practice of the JFTC has rarely been challenged in the courts, and thus virtual per se illegality has been achieved for price cartels. However, the same reasoning cannot be adopted for quantity restraints, territorial divisions, and other restraints regarded as per se illegal in the United States and the EU. It is desirable that the JFTC and the courts explicitly adopt per se illegality for "hard-core" cartels to enable the JFTC to more efficiently tackle cartels. Explicit adoption of per se illegality is supported by the fact that the Japanese government, by endorsing the recommendation by the Organisation for Eco-

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42 Toho/Subaru, 4 (14) KOUSAI MINSHU 497, 518 (Tokyo High Ct., Sept. 19, 1951).

43 U.S. Dep't of Justice & FTC, Horizontal Merger Guidelines § 0.1 (1992, rev. 1997), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.htm [hereinafter Horizontal Merger Guidlines].

nomic Co-operation and Development (OECD), pledged to ensure deterrence of hard-core cartels.[44]

The JFTC published its Distribution Guidelines,[45] after the U.S. government pressured the Japanese government, in the U.S.-Japan Structural Impediment Initiative,[46] to reduce trade barriers through rectifying anticompetitive regulatory systems, among which weak competition law enforcement was near the top of the list. The Distribution Guidelines adopted an "illegal in principle" position against price cartels and similar hard-core cartels or restraints—"agreements not to compete for customers, group boycotts, and resale price maintenances."[47] Nevertheless, illegal in principle is ambiguous compared to per se illegality. Moreover, the courts, not being obliged to observe JFTC guidelines, have never adopted an illegal in principle standard for hard-core cartels.

Lack of per se illegality has so far not posed great legal challenges to the JFTC in court, since the JFTC's delineation of narrow markets in horizontal agreement cases has never been seriously challenged. However, the JFTC, in its 2007 Business Combination Guidelines, adopted an economic method (the so-called hypothetical monopolist test) for market delineation.[48] If defendants challenged the JFTC's market delineation based on this method, the JFTC would be forced to go into the complicated task of market delineation. This would result in a substantial loss of administrative efficiency in tackling cartels.

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[44] *See* Organisation for Economic Co-operation and Development, *Recommendation Concerning Effective Action Against Hard Core Cartels,* C(98)35/FINAL (Mar. 25, 1998) at §1, *available at* http://www.oecd.org/dataoecd/39/4/2350130.pdf ("Member countries should ensure that their competition laws effectively halt and deter hard core cartels.").

[45] JFTC, Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act (July 11, 1991), *available at* http://www.jftc.go.jp/e-page/legislation/ama/distribution.pdf [hereinafter Distribution Guidelines].

[46] Joint Report, *supra* note 4.

[47] Distribution Guidelines, *supra* note 45, Introduction at § 3.

[48] Business Combination Guidelines, *supra* note 5, at § II.1.

It is desirable that per se illegality of hard-core cartels be explicitly stipulated in an amended AMA. This may be done by following the model of EC competition law in article 81 in the E.C. Treaty,[49] which prohibits all agreements that have as their "object" the restriction of competition.

3. TREATMENT FOR A CONCERTED REFUSAL TO DEAL Concerted refusals to deal should be classified into two kinds: (1) those with legitimate objectives, often implemented by cooperative joint ventures[50] and (2) group boycotts with the predominant objective of blocking new entrants.

The latter type of concerted refusal to deal (pure group boycotts) have been condemned as per se illegal in the United States. By contrast, the absence of per se illegality in the AMA has caused the JFTC and the courts to adopt the literal application of the AMA clauses. Concerted refusals to deal may be classified by the AMA as (1) horizontal agreements ("unreasonable restraint of trade"), (2) monopolization, or (3) unfair trade practices. The first and second regulations require a finding of market power ("substantial restraint of competition"), while the third regulation requires only a finding of impeding effects on competition. The JFTC, therefore, can most easily find illegality in a concerted refusal to deal by the use of the unfair trade practices clause, which, nevertheless, is lacking in penalties.

The JFTC had regulated concerted refusals to deal exclusively as unfair trade practices. However, in its Distribution Guidelines,[51] the JFTC announced its intention to apply the "unreasonable restraint of trade" clause to concerted refusals to deal. This policy change aimed to levy penalties on group boycotts, which have often been made use

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49 *See* Treaty Establishing the European Community, Feb. 7, 1992, 1992 O.J. (C 224) 1, art. 81.

50 *See* Nw. Wholesale Stationers v. Pac. Stationery & Printing Co., 472 U.S. 284, 295 (1985) ("Wholesale purchasing cooperatives . . . are not a form of concerted activity characteristically likely to result in predominantly anticompetitive effects. Rather, such cooperative arrangements would seem to be 'designed to increase economic efficiency and render markets more, rather than less, competitive.'").

51 Distribution Guidelines, *supra* note 45.

of in conjunction with bid rigging to block outsiders, including foreign companies. The JFTC's new policy was in line with the Japanese government's policy of opening up the Japanese economy. At that time, in 1991, surcharges could not be levied on group boycotts, but with the 2005 AMA revision, surcharges can be levied on group boycotts so long as they affect prices.[52]

Nevertheless, the lack of per se illegality and the consequent need for identifying market power place a considerable burden on the JFTC and private complaining parties to prove the illegality of group boycotts. The Osaka High Court in *Kansai Airport Newspaper Distribution*,[53] a private action case, exemplifies this point. In this case, a new entrant to the newspaper retail business at Kansai Airport was met with a group boycott created by five wholesale distributors. Despite the occurrence of a group boycott, the High Court denied it was illegal under the unfair trade practices clause of the AMA. This was on the grounds that the appellant could purchase newspapers from a retail distributor other than the five wholesalers.[54]

This decision may, first, be interpreted as showing a deficiency caused by the lack of per se illegality. The group boycott in this case did not accompany any legitimate objective, but merely amed to prevent new entry. Therefore, if there had been a per se illegal standard against a pure group boycott, the wholesalers would have been found to have adopted an illegal trade practice. Second, this decision is wrong, even from a literal application of the AMA clauses, since it negated any illegality of the group boycott only by noting the availability of a single retail distributor. The appellant suffered an increase in cost by being forced to purchase from outside the established wholesalers. The five wholesalers in combination had market power and did not present any efficiency reason for the boycott: therefore, even without a per se illegality standard, they should have been found to have adopted an illegal trade practice, under either the unfair trade practices clause or the unreasonable restraint of trade clause.

52 *See* AMA, art. 7-2 (1).

53 52 Shinketsushu 856 (Osaka High Ct., July 5, 2005).

54 *Id*. at 875.

B. *Measures against bid rigging*

Bid rigging has been a principal focus in the JFTC's enforcement of the AMA. In the five years leading up to fiscal 2006, bid rigging cases constituted 59% (69 of 116) of all JFTC decisions and remedy orders.[55] Bid rigging was shown to have become an established custom in construction and other infrastructure industries; indeed the practice was encouraged by the national and local government officials who supervised public bidding. This trend changed around the end of the twentieth century because of changes in Japanese politics. The Japanese government had begun to put more emphasis on competition and efficient use of the public budget. Keeping pace with this national policy, public prosecutors started to vigorously prosecute bid rigging both in response to appeals from the JFTC and independent of any JFTC action.

Bid rigging is illegal under the AMA as an illegal horizontal agreement ("unreasonable restraint of trade"). Due to the lack of a per se illegal standard, the JFTC needs to prove market power ("substantial restraint of competition") among bid-rigging participants. Nevertheless, bid rigging, by artificially raising prices, always fulfills the market power requirement. The most difficult issue lies in the identification of an agreement. See part IV.D below.

Surcharges are levied on illegal bid rigging. Furthermore, when the JFTC appeals to the Public Prosecutor's Office for a prosecution, bid-rigging becomes a criminal case with possible criminal penalties. In fiscal years 2005, 2006, and 2007, the JFTC requested prosecutions of two, two, and one bid rigging case, respectively.[56]

As well as the criminal bid rigging cases brought by the JFTC under the AMA, the Public Prosecutor's Office can, on its own initiative, prosecute bid rigging under the provision of the Penal Code[57] against the disruption of competitive bidding. Indeed the Public Prosecutor's Office has increased use of this route to act against bid rigging.

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[55] JFTC, 2007 Nenji-Houkoku (Annual Report) at 32 (June 2008).

[56] *Id*. at 70.

[57] *See* Penal Code, Act No. 45 of 1907, art. 96-3, *available at* http://www.cas.go.jp/jp/seisaku/hourei/data/PC2.pdf.

Much bid rigging has been encouraged or even led by government officials, both national and local, who seek post-retirement positions in construction companies. Theoretically, such officials may be prosecuted as accomplices of the executives of the companies prosecuted for criminal activity. Nevertheless, such a prosecution against officials has not been brought. However, in response to increasing public outcry against such involvement by officials in the bid rigging process, the Diet passed a new law that specifically targeted government officials.[58] This law—the Bid Rigging Involvement Act—enabled the JFTC to demand that the government agencies involved in bid rigging take disciplinary action against any responsible officials, including requests for damage compensation. Moreover, the 2007 amendment of the Act made possible criminal penalties against such officials.[59]

C. Efficiency defenses for agreements with market power

The JFTC has taken a position that horizontal agreements that result in market power ("substantial restraint of competition") fall into "unreasonable restraints of trade," and are thus illegal. This position signifies that, for "unreasonable restraint of trade" cases, no rule of reason type analysis is implemented.[60] By contrast, vertical agreements or restraints, against which the clause on unfair trade practices is applied, have been analyzed by rule of reason. See part V.E below.

The legal distinction between using an unreasonable restraint of trade clause for horizontal agreements and an unfair trade practices

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[58] Act Concerning Elimination and Prevention of Involvement in Bid Rigging, Law No. 101 of 2002, *available at* http://www.jftc.go.jp/e-page/legislation/ama/elimination_bidrigging.pdf.

[59] *See id*., art. 8.

[60] By contrast, U.S. antitrust agencies analyze horizontal agreements, other than naked conspiracies, by rule of reason. In rule of reason analysis, a horizontal agreement should be scrutinized to determine first "whether the agreement may create or increase market power or facilitate its exercise," and second, "whether the relevant agreement is reasonably necessary to achieve procompetitive benefits that likely would offset anticompetitive harms." *See* U.S. Dep't of Justice & FTC, Antitrust Guidelines for Collaborations Among Competitors §1.2 (2000).

clause for vertical agreements has caused a logical inconsistency in that horizontal agreements, in contrast to vertical ones, are not capable of being exonerated on grounds of efficiencies or other procompetitive defenses. For example, an agreement among technology companies to create a standard (e.g., a DVD technology standard) would be found illegal when the agreement forms market power, even though the agreement may bring great benefit to consumers through establishment of a unified format.

It is desirable that the JFTC and the courts explicitly acknowledge that efficiency and other procompetitive defenses may be considered in the scrutiny of "unreasonable restraint of trade," through the qualitative identification of "substantial restraint of competition" (market power). This would lead to a legal standard under which horizontal agreements are exonerated even when market power is formed if efficiency and other rationales more than compensate for the effects of the market power. This standard would lead to the same rule of reason analysis found in the U.S. Antitrust Guidelines for Collaborations among Competitors.

Such a rule of reason type standard has already been applied in a regional court decision. The Tokyo Regional Court decision in *Air Soft Gun*[61] concerned a group boycott by an air gun manufacturers' association against an outsider who had been selling air guns that the association's code of conduct prohibited as dangerous to the public. The decision found that the association members held a nearly 100% market share, and thus the boycott fulfilled the conditions for a "substantial restraint of competition." Nevertheless, the decision held that such conduct may be found *not* in violation of the AMA when the comparative consideration of the anticompetitive effects against the compensating public benefits leads to the conclusion that the ultimate objective of the AMA was not sacrificed. Such conduct, the decision concluded, is not against "public interest," and thus does not ultimately form a "substantial restraint of competition."[62] Nevertheless, as I pointed out in part II.B above, the "public interest" clause (AMA article 2(6)) should not be utilized for qualitative considerations of

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[61] 44 SHINKETSUSHU 635 (Tokyo Reg. Ct., April 9, 1997).

[62] *Id*. at 682–83.

competition, which should rather be analyzed through the rule of reason anaysis on "substantial restraint of competition."

D. *Finding an agreement*

As a condition for identifying an illegal cartel, the JFTC needs to find an agreement among the targeted companies. This is a universal requirement for identifying an illegal cartel. A unique issue arising from the AMA is the need to identify "mutual restriction" among companies.

1. NEED FOR MUTUAL RESTRICTION AMA article 2(6), in relevant part, stipulates: "The term 'unreasonable restraint of trade' as used in this Act means such business activities, by which any entrepreneur, by contract, agreement or any other means irrespective of its name, in concert with other entrepreneurs, mutually restrict or conduct their business activities . . . causing . . . a substantial restraint of competition in any particular field of trade."

Under U.S. and EU competition laws, agreements are identified broadly, irrespective of the relationships among cartel participants. However, in Japan, the phrase "mutually restrict" gave rise to two additional requirements for identifying an illegal "unreasonable restraint of trade." These were set up by the Tokyo High Court *Newspaper Distribution Agreement*[63] decision and subsequent JFTC decisions. First, "mutual restrictions" may be found only for agreements among horizontally competing companies. Therefore, agreements among companies in a vertical relationship (for example, a manufacturer and distributors) may not be condemned as an unreasonable restraint of trade. Vertical agreements, then, are regulated only as unfair trade practices. See part V.A. below.

Second, a transaction between companies in which one party is deemed to have unilaterally imposed a restricting condition on another party, is not considered mutually restricting and thus may not be condemned as an unreasonable restraint of trade. This situation typically has arisen in bid rigging cases in which one party gets a contract while the other parties are constrained to make higher bids, so that mutual constraint is not found. Therefore, those bid rigging situations, for which rotation agreements for winning bidding contracts are not

[63] 6 (9) KOUSAIMINSHU 435, 479–80 (Tokyo High Ct., Mar. 9, 1953).

found, would escape condemnation. To correct this pitfall, the JFTC, in the recent decision of *Shikoku Road Service*,[64] condemned such bid rigging as an illegal "unreasonable restraint of trade" on the grounds that the company that won the contract was constrained to execute the winning bid; therefore "mutual restraint" may be identified.[65]

The requirement of "mutual restriction" should be interpreted loosely so as not to obstruct the objective of condemning anticompetitive agreements. It is desirable that in a future AMA revision the phrase "mutual restriction" be deleted from the definition of "unreasonable restraint of trade."

2. TREATMENT OF IMPLICIT AGREEMENTS OR PRICE LEADERSHIP An agreement may not be found from the mere existence of a parallel price increase, but a parallel price increase together with circumstantial evidence may lead to a finding of an agreement. This has become a common standard in competition laws worldwide, including under the AMA. In the early history of the AMA, the JFTC, in the *Yuasa Wood Products*[66] decision, took U.S. jurisprudence as a model and assumed that a parallel price increase, in conjunction with circumstantial evidence, may be found to form an agreement.

However, after *Yuasa Wood Products*, the JFTC became conservative in finding agreements. In the now abolished Guidelines on the Construction Industry, promulgated in 1984, the JFTC stipulated that information exchanges among industry association members and governmental agencies do *not* "in principle" constitute agreements. Such a narrow interpretation of agreements led to the weakening of JFTC's condemnation of price cartels and bid rigging in particular.

Nevertheless, since around 1990, the JFTC has returned to the *Yuasa Wood Products* standard and has identified agreements from circumstantial evidence. This stance by the JFTC was supported by the Tokyo High Court in *Toshiba Chemical*, in which explicit proof of an

[64] 49 SHINKETSUSHU 243, 246 (FTC, Dec. 4, 2002).

[65] Hideo Kosuge, *The AMA Case on* Japan Road Public Association [Nihon Doro Kodan . . . Jiken], 628 Kosei Torihiki (Fair Trade) 88, 93 (2003) (commenting on the JFTC decision).

[66] 1 SHINKETSUSHU 62, 79–82 (FTC, Aug. 30, 1949).

agreement was not found, but the companies were found to have held meetings and exchanged information on price before the parallel price increases. The decision held that "mutual communications of intent" may be found from facts of "implicit mutual understanding among companies about their price rises."[67]

Toshiba Chemical is the crucial decision in support of the JFTC stance of making use of circumstantial evidence to prove the existence of agreements. Nevertheless, the decision has a risk of being interpreted too widely, in a way that could condemn pure oligopolistic pricing, that is, price leadership. The JFTC should take care not to condemn such pure oligopolistic pricing, which may exist without any agreement.

3. THE ROLE OF LENIENCY IN DISCOVERING PRICE CARTELS AND BID-RIGGING The 2005 AMA revision introduced a leniency system into Japanese law that grants immunity from (or a reduction of) penalties arising from competition law violations in exchange for cooperation with the competition authorities. The leniency system has already proven very successful in uncovering price cartels in the United States and the EU.[68]

The leniency in the AMA is applicable only to surcharges, not to criminal penalties. Nevertheless, the JFTC pledged not to make representations asking for criminal penalties against the first informant company, its executives, and its employees.[69] Surcharges are levied on companies engaged in price cartels or bid rigging. See part II.C.2.b. above. The leniency system, therefore, functions to induce cartel participants to provide information to the JFTC. The first company to provide the relevant information is granted full leniency, the second informant a fifty percent reduction, and the third informant a thirty percent reduction.[70]

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[67] 42 SHINKETSUSHU 393, 417 (Tokyo High Ct., Sept. 25, 1995).

[68] *See* Wouter P.J. Wils, *Leniency in Antitrust Enforcement: Theory and Practice*, 30 WORLD COMPETITION 179 (2007).

[69] *See* Press Release, JFTC, Revision of the JFTC's Policy on Criminal Accusation (Oct. 6, 2005), *available at* http://www.jftc.go.jp/e-page/pressreleases/2005/Oct/051006.html.

[70] *See* AMA, art. 7-2. The 2008 bill to amend the AMA increases the number of companies entitled to leniency from three to five. *See* JFTC, *supra* note 15.

From its introduction in January 2006 up to the end of March 2008, the leniency system has generated as many as 179 instances of submission of information.[71] This number amounts to approximately six to seven instances a month. Many commentators had predicted that leniency would not work in Japan, on the grounds that leniency favors traitors and is not in harmony with Japanese culture, which favors harmonious relations among insiders. However, the results have proven that leniency functions as well in Japan as it does in the United States and the EU.

E. Suggestions for improvement

- It is desirable that the JFTC and the courts explicitly adopt per se illegality for hard-core cartels. This would enable the JFTC to tackle cartels more efficiently. It is also desirable that per se illegality of hard-core cartels be explicitly stipulated in an amended AMA by following the model of article 81 of the EC competition law, which prohibits all agreements that have as their "object" the restriction of competition.
- Concerted refusal to deal should be divided between (1) those with legitimate objectives and (2) group boycotts predominantly aiming at blocking entry. For the latter type of group boycotts, it is desirable that the JFTC and the courts adopt per se illegality.
- It is desirable that the JFTC and the courts explicitly allow efficiency and other procompetitive defenses in their analysis of "unreasonable restraint of trade," through rule of reason analysis on "substantial restraint of competition."
- The requirement of "mutual restriction" should be interpreted loosely so as not to obstruct the objective of condemning anticompetitive agreements. It is desirable that in future AMA revisions, the phrase "mutual restriction" be deleted from the definition of "unreasonable restraint of trade."

V. VERTICAL RESTRAINTS

Vertical restraints or agreements are transactions between companies in upstream markets (typically manufacturers) and companies in downstream markets (typically distributors or dealers). Companies in vertical transactions are not competitors, so the anticompetitive effects

[71] JFTC Annual Report, *supra* note 55, at 27.

of vertical restraints are generally weaker than those of horizontal agreements. Nevertheless, vertical restraints can have two restraining effects on competition: First, restriction of competition within one branded product (intrabrand competition restriction); and second, exclusion of competitors in the upstream market (vertical exclusion). These two anticompetitive effects are qualitatively different. Thus vertical restraints need to be divided into two categories: (1) vertical restraints restricting intrabrand competition; and (2) vertical exclusions.

A. Vertical restraints distinguished from horizontal agreements

Vertical transactions between noncompetitors are treated by competition laws as vertical agreements or restraints, depending on different viewpoints. U.S. and EU competition laws treat vertical transactions as vertical agreements and analyze the effects of agreements on competition and consumer welfare. By contrast, the AMA treats vertical transactions as restraints inflicted by manufacturers (more generally, upstream companies) on distributors (downstream companies).

This viewpoint was established by the Tokyo High Court *Newspaper Distribution Agreement*[72] regarding a restraint between a major newspaper company and its distributors. The decision held that the vertical restraint at issue was not an "unreasonable restraint of trade" defined by article 2(6) of the AMA, on the grounds that there was no "mutual restriction," since the restraint was unilaterally inflicted by the newspaper company on its distributors. In accepting this view, the JFTC did not apply the "unreasonable restraint of trade" clause to vertical restraints; instead, the JFTC applied the unfair trade practices clause. This resulted in levying neither criminal penalties nor surcharges on AMA violators engaging in vertical restraints.

The unfair trade practices clause in the AMA takes the position that vertical transactions are not agreements, but restraints imposed by upstream manufacturers on downstream distributors. This viewpoint is reflected in the terminology of the JFTC General Designation,[73] as

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[72] 6 (9) Kousaiminshu 435, 479–80 (Tokyo High Ct., Mar. 9, 1953).

[73] JFTC, Designation of Unfair Trade Practices, Fair Trade Commission Notification No. 15 of 1982, *available at* http://www.jftc.go.jp/e-page/legislation/ama/unfairtradepractices.pdf [hereinafter General Designation].

well as in that of AMA article 2 (9): "discriminate,"[74] "coerce,"[75] "impose (or restrict),"[76] and "dominant bargaining position."[77] Violators of the unfair trade practices clause regarding vertical restraints, then, are upstream manufacturers and other upstream companies, such as telecom operators.

B. *Unfair trade practices regulation*

In place of the unreasonable restraint of trade clause of article 2 (6), the unfair trade practices clause of article 2 (9) and JFTC General Designation have been applied to vertical restraints. The unfair trade practices clause, as already explained in the section on horizontal agreements, covers the whole area of anticompetitive conduct. The unfair trade practices clause is exclusively applicable to vertical restraints, excepting exclusionary vertical restraints, to which both the unfair trade practices and monopolization clauses are applicable.

1. STRUCTURE OF THE UNFAIR TRADE PRACTICES CLAUSE The unfair trade practices clause consists of AMA article 2 (9) and the JFTC Notification of 1982 (the General Designation).[78] The unfair trade practices clause identifies six types of illegal unfair trade practices.[79] The General Designation further divides these practices into fifteen types of possibly anticompetitive practices. In addition, the practices need to be found to "have danger to impede fair competition." The fifteen types of practices are not logically classified by the General Designation. However, I would classify these fifteen into six categories:

1. Exclusionary practices (General Designation §§1, 2, 6, 7, 8, 9, 15);
2. Vertical exclusionary practices (General Designation §§10, 11);

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[74] *Id.* at §3 (discriminatory pricing) and §4 (discriminatory transaction).

[75] *Id.* at §10 (tying).

[76] *Id.* at §12 (resale price maintenance) and §13 (trading on restrictive terms).

[77] *Id.* at §14 (abuse of dominant bargaining position).

[78] General Designation, *supra* note 73.

[79] The 2008 bill to amend the AMA contains changes in the description of article 2 (9). *See* JFTC, *supra* note 15.

3. Vertical intra-brand restriction of competition (General Designation §§12, 13);
4. Discrimination (General Designation §§3, 4);
5. Misrepresentation and deceptive practices to consumers (General Designation §§8, 9); and
6. Abuse of superior bargaining position (General Designation §14).

Vertical restraints fall into categories 1 and 2. Category 6 is almost always applicable to vertical restraints, since vertical restraints may be considered to be abuse by major manufacturers or retailers of their superior bargaining position against small distributors or suppliers. Moreover, discriminatory vertical restraints fall into category 4.

2. AMBIGUITY OF UNFAIR TRADE PRACTICES: THREE TYPES OF "UNFAIR" COMPETITION Under the unfair trade practices clause—in contrast to the unreasonable restraint of trade clause, the monopolization clause, or the merger regulation clause—the JFTC need not identify market power (substantial restraint of competition) to condemn conduct as illegal. Finding a mere "danger to impede fair competition" suffices for the JFTC to find conduct to be an illegal unfair trade practice when that conduct falls into one or several of the fifteen types of practices designated by the General Designation.

Therefore, the JFTC, under the unfair trade practice clause, has much latitude for finding illegality in vertical restraints. The JFTC, through its Distribution Guidelines, narrowed its ability to find illegality in vertical restraints. Nevertheless, the Distribution Guidelines, which presented only broad standards, still allow the JFTC wide discretion for finding illegality in vertical restraints.

The ambiguity of unfair trade practice regulation is amplified by the fact that the unfair trade practice clause has been considered to cover not only the usual areas for competition law—collusion and exclusion—but also "unfair competition," which is considered outside the area of competition law in the United States and the EU. The unfair trade practices clause aims to prohibit "unfair competition," which according to a majority of Japanese antitrust scholars and the JFTC consists of three categories of conduct: (1) impeding competition on merit or efficiency; (2) unfairness of competition methods; and (3) disruption of the fundamentals of free market order.[80] The first category of conduct concerns the usual types of anticompetitive conduct: collusion and exclusion. The second and third categories go beyond the usual competition law area, moving into the civil law area of tort. These two notions of "unfair competition" are not found in the U.S. and EU competition laws, but are found in some competition laws in Asian countries, including the Republic of Korea, which was influenced by the AMA. These two notions of "unfair competition" have been utilized by the JFTC for consumer protection and for protection of small and medium-sized companies. Such uses of unfair trade practices have made it difficult to limit areas of business conduct found to be illegal.

Defects emanating from the ambiguity of unfair trade practices are exemplified by the JFTC IP Guidelines. The JFTC promulgated its revised IP Guidelines in 2007.[81] The JFTC maintained the three categories above for unfair trade practices regulation, but exempted the two latter categories of unfair trade practices from the application of a safe harbor. Through this exemption, the safe harbor (defined as a market share of less than twenty percent) was robbed of much of its usefulness because a majority of business conduct can be condemned as constituting "unfair competition methods" or disrupting "fundamentals of free market order." Because of the ambiguity of what constitutes unfair competition methods, the new IP Guidelines render it unclear and difficult to foresee what kinds of IP licenses would be found illegal by the JFTC.

It is desirable that the JFTC make new guidelines on applications of the unfair trade practice clause and forsake or narrow down the concept of "unfair competition methods" and "fundamentals of free market order." The regulation of "unfair competition methods," which is used for consumer protection measures—that is, the regulation of misleading or fraudulent business conduct—should be stipulated as a role of the JFTC for direct consumer protection and distinguished from the regulation of anticompetitive conduct. In this

[80] These three categories of unfair trade practices were most recently adopted in the JFTC IP Guidelines, *supra* note 40.

[81] S*ee id.*

regard, section 5 of the U.S. Federal Trade Commission Act may function as a useful model. The consumer protection role of the FTC has been established as distinct from its role as a regulator of anticompetitive conduct.

3. CRITICISMS AGAINST THE PROPOSAL TO EXTEND SURCHARGES TO UNFAIR TRADE PRACTICES For violations of the unfair trade practices clause, the JFTC can order only remedies; criminal penalties and surcharges cannot be levied. The lack of penalties has often been shown as a reason to endow the JFTC latitude in finding illegal unfair trade practices. But the lack of penalties is common with monopolization clause; criminal penalties have never been levied for such violations. The JFTC's power to order remedies (in most cases, cease and desist orders), by itself, gravely restricts companies' freedom of business practice. Therefore, it is desirable that the JFTC eliminate ambiguities regarding unfair trade practices.

However, in March 2008, the JFTC and the government announced a bill to partially amend the AMA.[82] The bill introduces administrative surcharges on selected types of illegal unfair trade practices, including (1) unduly low pricing and discriminatory pricing, (2) concerted refusal to deal, (3) resale price maintenance, (4) abuse of superior bargaining position, and (5) misrepresentations in violation of the Act against Unjustifiable Premiums and Misleading Representations. While resale price maintenance and misrepresentations are clearly anticompetitive, the anticompetitive nature of the other unfair trade practices has remained ambiguous. Levying surcharges against ambiguous unfair trade practices would increase the danger of deterring competitive conduct.

C. Per se illegality of vertical price restraints

Among the vertical restraints on intrabrand competition, vertical price restraints, or resale price maintenance, have been treated as virtually illegal per se by the JFTC and the courts. This treatment is the same as that under EU competition law, but is different from the

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[82] JFTC, *supra* note 15.

interpretation given by the U.S. Supreme Court in *Leegin*.[83] The Supreme Court proclaimed that vertical price restraints should be scrutinized by the rule of reason, abolishing the long-standing concept of per se illegality.

Vertical price restraints fall into the JFTC's General Designation section 12 (resale price maintenance) as well as AMA article 2(9), which, in combination, stipulate that a vertical price restraint inflicted "without proper justification" is illegal when it has a danger of impeding fair competition.

The unfair trade practice clause does not require a finding of market power to identify illegal conduct. Suppression of intrabrand competition is, therefore, regarded as "impeding fair competition." Thus, the illegality of a vertical price restraint depends on whether it has "proper justification" or not. On this point, the Supreme Court, in *Meiji-Shoji*,[84] proclaimed that "proper justification" does not include a business- or transaction-related justification not associated with competitive order. Since this decision, no justification has been allowed in respect of vertical price restraints. Hence, vertical price restraints have been treated as per se illegal under the AMA.

One can argue that vertical price restraints restrict merely intrabrand competition, while they have procompetitive efficiencies, such as promotion of sales efforts; therefore, vertical price restraints should be scrutinized by rule of reason. Condemnation, then, should be restricted to manufacturers with market power. Nevertheless, the argument for the per se illegality of vertical price restraints is convincing in its emphasis on competition restraining effects on upstream manufacturers, as well as on the availability of alternative efficiency-increasing measures.[85] The JFTC and public opinion (particularly consumer groups) in Japan have supported this view for per se illegality.

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[83] Leegin Creative Leather Prods., Inc. v. PSKS, Inc. 127 S. Ct. 2705, 2720 (2007) ("[The] rule of reason, not a *per se* rule of unlawfulness, would be the appropriate standard to judge vertical price restraints.").

[84] 29 (6) MINSHU 951, 959 (Sup. Ct., July 10, 1975).

[85] *See Leegin*, 127 S. Ct. 2705, 2725–37 (Breyer, J., dissenting).

The AMA includes a limited exemption clause, divided into two parts, for vertical price restraints in article 23. Article 23(1)–(3) prescribes exemptions designated by the JFTC. Article 23 (4) prescribes a mandated exemption for copyrighted published goods (books and musical CDs). The JFTC has accomplished the abolition of JFTC-designated exemptions. Before the abolition, cosmetics and pharmaceuticals had been exempted from the ban on vertical price restraints. Exemptions for vertical price restraints are now limited to the legally mandated exemption of copyrighted published goods.

D. Distinction between price and nonprice restraints

Vertical price restraints are treated as illegal per se, while nonprice restraints are scrutinized by a rule of reason analysis explained below. Despite this contrast, it is often difficult to distinguish price restraints from nonprice restraints.

It would be convenient for the JFTC (and plaintiffs in private suits) to interpret all vertical restraints on intrabrand competition as price restraints on the grounds that they invariably exert price raising effects. However, this reasoning would end up abolishing the distinction between price and nonprice restraints. This point was discussed by the Supreme Court in *Fujiki v. Shiseido*.[86] This private suit concerned Shiseido, Japan's largest cosmetics company. Shiseido's contract clauses with its distributors were judged on whether they were price restraints or nonprice restraints. Shiseido avoided including price restraints in its contracts with distributors, but the contracts contained numerous obligations for distributors, in particular, the obligation to offer face-to-face consulting to each customer. One discounter, whose contract Shiseido terminated on the grounds that the distributor was negligent in observing these obligations, filed suit arguing that the contract clauses violated the AMA. The regional court judged that the obligation to supply face-to-face consulting amounted to a price restraint because it had the effect of making the operations of discounters impossible. However, the Tokyo High Court reversed the regional court decision, opining that "price stabilizing effects," by

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[86] 45 SHINKETSUSHU 455 (Sup. Ct., Dec. 18, 1998).

themselves, do not lead to illegality under the AMA. The Supreme Court supported the High Court decision on this point.[87]

This decision made it clear that without mandatory price restraints (including effective restraints backed by the withdrawal of rebates), a wide range of vertical restraints would be analyzed as non-price restraints. This situation is similar to that in the United States where the Supreme Court in *Sharp Electronics*[88] held that a contract termination with a discounter, by itself, does not amount to per se illegal price restraint.

E. Vertical nonprice intrabrand restraints—rule of reason type scrutiny

Vertical nonprice intrabrand restraints include territorial restraints and other nonprice restraints that are typically imposed by manufacturers on their distributors. Vertical nonprice intrabrand restraints fall under General Designation section 13 (prohibition of unjustly restrictive dealings) and AMA article 2(9), which, in combination, stipulate that imposing unjustly restrictive conditions (other than price restraints) on transaction partners is illegal when the conditions exert a danger that could impede fair competition.

The phrase "unjustly" in General Designation section 13 and others, in contrast to the phrase "without proper justification" in section 12 and others, is meant to signify that the designated practices are not condemned as illegal per se, but are scrutinized on their reasonableness. This distinction between nonprice restraints and price restraints is based on a generally acknowledged difference in anticompetitive effects; the former exerts pernicious anticompetitive effects through the direct suppression of intrabrand price competition as well as the facilitation of interbrand collusion.

Tying the illegality to reasonableness is akin to the rule of reason conducted in the United States. Nevertheless, contrary to the rule of reason in modern U.S. antitrust jurisprudence, finding illegality

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87 *Id*. at 459.

88 Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988).

under unfair trade practices clauses does not require a finding of market power.

The JFTC, in its Distribution Guidelines,[89] elaborated on how it determines illegality for vertical nonprice intrabrand restraints. The Distribution Guidelines classify vertical nonprice restraints into three types, depending on the degree of anticompetitive effects: (1) restraints that are always treated as legal, such as non-rigid territorial arrangements; (2) restraints found illegal when they are conducted by manufacturers with a "significant position in the market," such as rigid territorial restraints forbidding sales outside territories; and (3) restraints found to be almost per se illegal, namely, where a mere finding of a "danger to raise or maintain price" is enough for the JFTC to identify illegality, such as an absolute territorial restriction forbidding accepting offers from outside territories, or a ban on sales to discounters.

The JFTC's position toward vertical nonprice restraints is qualitatively more severe than that of the U.S. rule of reason, where nonprice restraints have rarely been found illegal. Nevertheless, Japanese courts are not obliged to observe the JFTC Distribution Guidelines, and in recent private action cases they have presented rule of reason analyses. The *Sankomaru*[90] is a typical example. This concerned a rigid territorial restraint imposed by a pharmaceutical manufacturer. The Tokyo Regional Court did not just follow the JFTC Distribution Guidelines, it proposed three conditions for a rigid territorial restraint to be found illegal: (1) the manufacturer conducting the restraint should occupy a "significant position in the market"; (2) the restraint forms an unreasonable restraint on the distributor's business; and (3) the restraint exerts price-restraining effects.[91]

The first condition is the same as that in the Distribution Guidelines, but the second and the third conditions are not. The Tokyo Regional Court found the defendant's actions *not* illegal on the grounds that the defendant lacked a "significant position in the market"; the defendant occupied only a small share of the relevant phar-

89 Distribution Guidelines, *supra* note 45, at §II.

90 51 SHINKETSUSHU 877 (Tokyo Reg. Ct., Apr. 15, 2004).

91 *Id*. at 913–16.

maceutical market. Although the *Sankomaru* decision is ambiguous about the meanings of "significant position in the market," "unreasonable restraint," or "price restraining effects," the decision shows a clear inclination toward rule of reason analysis and away from the rigid standards of the Distribution Guidelines.

The earlier *Fujiki v. Shiseido* decision,[92] although rendered by the Supreme Court, has less significance than *Sankomaru*. In *Fujiki v. Shiseido,* the Supreme Court held that restraints on sales methods (a consultation obligation toward customers, quality control, etc.) levied by a manufacturer on distributors may not be found as unjustly restricting, as far as the restraints are "based on a certain degree of reasonableness for the product's sales, and at the same time, other distributors are levied the same restraints."[93] This decision, if it is interpreted to cover all vertical nonprice restraints, is considerably more lenient than the Distribution Guidelines and may lead to the almost per se legality of nonprice intrabrand restraints.

The JFTC, naturally, does not like this interpretation. Therefore, in its *Sony Computer Entertainment Co. (SCE)* decision,[94] the JFTC limited the relevance of the Supreme Court's analysis ("a certain degree of reasonableness" test) to nonprice restraints implemented in situations similar to *Fujiki v. Shiseido*, in which face-to-face consultation was forced on distributors.[95] In the *SCE* case, SCE (a subsidiary of Sony dealing in Sony Play Stations) prohibited, among other things, each of its sole distributors from making sales to other sole distributors. The JFTC hearing examiners declined to apply the *Fujiki v. Shiseido* standard to this nonprice restraint and noted: (1) the restraint has the effect of abolishing competition between distributors; and (2) the restraint's illegality would be saved only if the restraint reflects an exceptional need and reasonableness. The examiners found no such exceptional need or reasonableness; therefore, the restraint's illegality was not negated.[96]

92 Fujiki v. Shiseido, 45 SHINKETSUSHU, 455 (S. Ct., Dec. 18, 1998).

93 *Id*. at 458.

94 48 SHINKETSUSHU 3 (FTC, Aug. 2, 2001).

95 *Id*. at 62.

96 *Id*. at 65.

The JFTC and the courts' standards on nonprice restraints have been evolving, and the Distribution Guidelines may no longer be regarded as the leading standard. It is desirable that the JFTC set up new and expanded guidelines with coverage not limited to distribution issues but extended to all vertical restraints.

F. Vertical exclusion

1. PARALLEL APPLICATIONS OF THE UNFAIR TRADE PRACTICE AND MONOPOLIZATION CLAUSES Exclusionary conduct, both vertical and horizontal, is regulated as either unfair trade practices under AMA article 2(9) and the General Designation or monopolization under articles 3 and 2(5). For the JFTC, the unfair trade practices clause is more convenient to apply because it does not require the identification of market power for a determination of illegality. Moreover, the two clauses present no practical difference in regard to the JFTC's power to levy sanctions as well as remedies.

The JFTC, therefore, until about 2000, had invariably applied the unfair trade practices clause to exclusionary conduct. However, since the beginning of the 21st century, the JFTC started to apply the monopolization clause to exclusionary conduct when it is implemented by dominant companies. Still, the JFTC opts more often to apply the unfair trade practices clause rather than the monopolization clause, even to conduct by dominant companies because the JFTC often finds it difficult to prove market power after properly delineating markets.

Exclusive dealing and tying are two of the most representative vertical exclusionary practices. The General Designation on unfair trade practices is equipped with individual sections precisely targeted against these two practices—section 10 for tying and section 11 for exclusive dealing. Thus these two types of vertical exclusions have almost always been regulated by the unfair trade practices clause, although the JFTC can apply the monopolization clause as well.

2. TYING: PRESUMPTION OF ILLEGALITY WITH A SAFETY DEFENSE The modern understanding of competition law is that the anticompetitive effect of tying lies in its exclusionary effect toward competitors in the market for a tied product. However, General Designation section 10 is

ambiguous on this point. Section 10, in combination with AMA article 2(9), finds tying illegal when it constitutes unjust coercion to purchase another product of the coercer, thus impeding fair competition. Compared to General Designation section 11 on exclusive dealing, section 10 lacks the expression "danger to reduce business opportunities for competitors." Consequently, the JFTC's Distribution Guidelines did not adopt, for tying, the near market power test[97]: an "influential position in a market," which is judged by a market share of not less than ten percent or its position among the top three in the market.

Therefore, contrary to the modern understanding of competition law, the General Designation and the Distribution Guidelines do not limit the anticompetitive nature of tying to the exclusion of competitors. The JFTC and the courts, by emphasizing the "fair" competition aspect of the unfair trade practice clause, have treated section 10 as a consumer protection clause, stating: "[Tying] robs purchasers of the right to choose products, impeding fair competition based on merit, and thus is unreasonable."[98]

The JFTC and the courts have thus considered tying as inherently illegal on the grounds that tying robs consumers of the right to choose. Consequently, the JFTC and the courts have neither analyzed market power in companies conducting tying, nor admitted efficiency and other defenses, excepting a safety defense. In *Toshiba Elevator*, the Tokyo High Court took into consideration the safety defense put forth by defendant Toshiba Elevator, although it concluded that tying of elevator maintenance with parts supply was not rationalized for safety sake.[99] This case concerns the aftermarket in a high-technology product and thus has a common character with the U.S. *Kodak* decision.[100] However, in contrast to *Kodak*, the Tokyo High Court did not

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[97] Distribution Guidelines, *supra* note 45, at part 1, V.2 (2).

[98] Toshiba Elevator, 40 SHINKETSUSHU 651, 660 (Osaka High Ct., July 30, 1993).

[99] *Id*. at 658–59.

[100] Eastman Kodak Co. v. Image Technical Services Inc., 504 U.S. 451 (1992).

find it necessary to delineate a relevant market because, under section 10, tying is illegal regardless of market power.

Although the JFTC still maintains this standard against tying, in recent tying cases it has adopted the viewpoint common with the U.S. and EU authorities: that is, viewing the anticompetitive effects of tying as the exclusion of competitors in the tied product market. In the JFTC decision of *Microsoft I,* Microsoft's tying of Excel with Word was found to be an illegal unfair trade practice, on the grounds that PC manufacturers, denied the ability to license only Excel, were obliged to agree to licensing Word as well.[101] Thus, the share of Word in the Japanese word processor market considerably increased, eventually becoming the largest. This was at the expense of the long established leader—Ichitaro of Just System.

It is desirable that the JFTC and the courts forsake the viewpoint that tying is inherently illegal on the grounds of robbing consumers of product choice. As far as competition exists in the tying product market, consumers are not forced to purchase the tied product. Market power, or power to force consumers to choose the combination of tying and tied products, should be explicitly required for finding tying illegal. Additionally, defenses for tying should be extended beyond safety reasons to those encompassing business efficiencies.

3. EXCLUSIVE DEALING: FORECLOSURE STANDARD Exclusive dealing is restraint by a manufacturer or other upstream company levied on its distributors to deal exclusively with the manufacturer and not with competitors of the manufacturer. General Designation section 11, in combination with AMA article 2(9), finds exclusive dealing illegal when it is "unjust (unreasonable)," and exerts a danger of reducing competitors' business opportunities, thus exerting a danger of impeding fair competition. This standard is so loose that it may end up making all exclusive dealings illegitimate since exclusive dealings invariably lessen the prospects for competitors to find distributors.

a. Exclusive dealing by major manufacturers is found illegal The JFTC, in its Distribution Guidelines, set up narrower standards than those in General Designation section 11 by stipulating that only companies

101 Microsoft I, 45 SHINKETSUSHU 153, 155–58 (FTC, Dec. 14, 1998).

with an "influential position in a market" will be found to be engaged in illegal exclusive dealing.[102] "Influential position in a market" may be found for companies lacking market power, as it is judged by a market share of not less than ten percent or a position among the top three in the market.[103] Nevertheless, the Distribution Guidelines additionally set up a market foreclosure standard by which exclusive dealing is found illegal when it is "difficult for new entrants and existing competitors to easily find alternative distribution routes."[104]

The foreclosure standard is found in both U.S. and EU regulation of exclusive dealing. Nevertheless, the JFTC standard falls short of requiring market power for a finding of illegality. Therefore, compared to the current U.S. standard (rule of reason, with the requirement of market power[105]), the JFTC standard is more severe against manufacturers.

Exclusive dealing, when adopted by a company with market power, fulfills the conditions for illegal monopolization. In such cases, the JFTC has discretion to use either the unfair trade practices clause or the monopolization clause. Since 1998, the JFTC has found just two exclusive dealing arrangements illegal under the monopolization clause. See part VII.B. below.

The JFTC has never allowed an efficiency defense for exclusive dealing, either in its Distribution Guidelines or its study reports on distribution practices. However, recent court decisions in *Sankomaru* and *Fujiki v. Shiseido* have allowed efficiency defenses for cases of intrabrand vertical restraints. See part V.E. above. No reason can be found to distinguish exclusionary vertical restraints from intrabrand vertical restraints on efficiency defenses; therefore, it is expected that future court cases will admit efficiency defenses for vertical exclusions in their analysis of "danger to impede fair competition."

b. Exclusive dealing induced by rebates Current JFTC standards on exclusive dealing require only a certain degree of foreclosure to find

102 Distribution Guidelines, *supra* note 45, at part 1, §IV. 2.

103 *Id*. at part 1, §IV. 2 n.7.

104 *Id*. at part 1, §IV. 2.

105 *See* United States v. Microsoft Corp., 253 F.3d 34, 70 (D.C. Cir. 2001).

exclusive dealing illegal. Therefore, major manufacturers engaging in exclusive dealing run considerable risks of being found to have engaged in illegal practices by the JFTC or the courts. Moreover, the U.S. and EU governments and manufacturers, in trade negotiations with the Japanese government, have complained about exclusive dealing arrangements conducted by Japanese manufacturers in the automobile, photographic film, and paper industries.[106] Their belief is that exclusive dealing has reduced the chances for foreign manufacturers to enter Japanese markets. Nevertheless, the JFTC has never rendered a decision against exclusive dealing in these industries because, following the JFTC's advice, those manufacturers had already abolished clauses on exclusive dealing from their contracts with distributors. Therefore, the current allegedly closed distribution systems in Japan are not caused by exclusive dealing contracts, but rather are the result of voluntary actions by distributors to deal with just one manufacturer.

These apparently voluntary actions by distributors may actually have been induced by rebates and other marketing benefits given by the manufacturers. The JFTC in its Distribution Guidelines proclaimed that rebates, when they constitute coercion on distributors to deal exclusively with one manufacturer, are equivalent to exclusive dealing.[107] Nevertheless, the JFTC has never rendered a decision finding rebates or other marketing measures to be illegal exclusive dealing.

c. Parallel exclusive dealing arrangements and efficiencies A common feature among the automobile, photographic film, paper, and sheet glass industries in Japan is that all domestic incumbents commonly adopt virtual exclusive dealing arrangements by way of sole distributorships. An individual manufacturer's exclusive dealing arrangement by itself does not create substantial foreclosure. But, all exclusive dealing arrangements combined in an industry create grave foreclosure against new entrants, including foreign companies. On this issue, the JFTC in its Distribution Guidelines stated: "When

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[106] Regarding Japanese photographic film industry, the U.S. government filed a complaint with the World Trade Organization. *See* World Trade Organization, Dispute Settlement, *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R (Mar. 31, 1998). The United States lost this case.

[107] Distribution Guidelines, *supra* note 45, at part 2, §III.2.

several manufacturers, in parallel, adopt exclusive dealing[],"[108] market foreclosure effects become greater, and therefore parallel exclusive dealing arrangements are more likely to be found illegal.

On the same issue, the Tokyo High Court in *Toyo Seimaiki*[109] expressed a contrary opinion: a major manufacturer's exclusive dealing may be found to lack the "danger to impede fair competition," when other manufacturers in the market also adopt exclusive dealing. The Tokyo High Court did not elaborate on their reason for this opinion; therefore, commentators have largely supported the JFTC Distribution Guidelines. Nevertheless, in *Toyo Seimaiki* one may observe reasoning similar to that expressed in U.S. court decisions: that parallel exclusive dealing arrangements may be taken as proof of the efficient nature of exclusive dealing.[110]

G. *Suggestions for improvement*

- Unfair trade practices regulation, through notions of "unfair competition," has been utilized by the JFTC for consumer protection and for protection of small and medium-sized companies. Such uses of the unfair trade practices clause have made it difficult to limit areas of business conduct found to be illegal unfair trade practices. It is desirable that the JFTC, by making new guidelines on unfair trade practices, forsake or limit the concept of "unfair competition methods" or "fundamentals of free market order."
- As to the regulation of "unfair competition methods" used for consumer protection measures—the regulation of misleading or fraudulent business conduct—should be stipulated as a role for the JFTC for direct consumer protection, a role distinct from the JFTC's regulation of anticompetitive conduct.
- The JFTC and the courts' standards on nonprice restraints have been evolving, and the Distribution Guidelines may no longer be regarded as the leading standard. It is desirable that the JFTC set up newly expanded guidelines with coverage not limited to distribution issues but extended to all vertical restraints.

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108 *Id*. at part 2, §II.2 n.5.

109 30 SHINKETSUSHU 136, 153 (Tokyo High Ct., Feb. 17, 1984).

110 *See* Paddock Publ'ns, Inc. v. Chi. Tribune Co., 103 F.3d 42, 44 (7th Cir. 1996) ("[The plaintiff] concedes that each [defendant] has adopted its method of doing business independently; they take the same approach to distribution because each has discovered that it is the most profitable way to do business.").

- It is desirable that the JFTC and the courts forsake the viewpoint that tying is inherently illegal on the grounds of robbing consumers of product choice. As far as competition exists in the tying product market, consumers are not forced to purchase the tied product. Market power, or power to force consumers to choose the combination of tying and tied products, should be explicitly required for finding tying illegal. Additionally, defenses for tying should be extended beyond safety reasons to those related to business efficiencies.

VI. MERGERS

Merger regulation in major competition laws deals with the consolidation of independent companies into one decision unit. Therefore, mergers regulated by competition laws are not restricted to formal mergers, but also include the acquisition of another company's voting stock or assets. The AMA regulates mergers in this sense, and prescribes that mergers are blocked when they give rise to "substantial restraint of competition," namely market power.[111]

Nevertheless, the AMA, in contrast to U.S. and EU competition laws, does not regulate mergers by a single clause, but sets up separate clauses: article 15 for formal mergers and article 10 for stock acquisitions. The separation of clauses created different treatment regarding premerger notifications between formal mergers and stock acquisitions. Two other separate clauses were also established: article 13 for interlocking directorates and article 16 for partial business transfers aimed, in a broad sense, at the same objective of merger regulation.

Stock acquisitions become the target of broad merger (formally named "business combination") regulation when the acquirer is able to control or substantially affect the business decisions of the acquired company. Such power over business decisions is invariably assumed for possession of or more than fifty per cent of voting stock, but also, depending on the situation, of or more than twenty percent of voting stock.[112]

The JFTC has modernized its merger regulation through revisions of its Business Combination Guidelines. The Business Combination

[111] *See* AMA, arts. 10, 15.

[112] *See* Business Combination Guidelines, *supra* note 5, at §I.1(1).

Guidelines have adopted basically the same economics-based approach first adopted by the U.S. Horizontal Merger Guidelines.

A market power test is used to identify mergers to be blocked. To measure market power, the concentration ratio resulting from a merger is calculated using the Herfindahl-Hirschman Index (HHI); safeguards from prohibition have been set up for mergers culminating in low HHIs. Relevant markets are delineated using the hypothetical monopolist or small-but-significant-and-nontransitory-increase-in-price (SSNIP) test; nevertheless, the traditional use and means test is also utilized. Efficiency defenses for mergers, otherwise blocked, are allowed in very limited circumstances.

A. Premerger notification obligation and consultation

Parties to substantial mergers, those where the assets of one of the parties exceed ten billion yen and the other one billion yen, are obliged, under the threat of punishment, to notify the JFTC before the merger's consummation.[113] The JFTC is mandated to complete the merger assessment within thirty days, though this may be extended under certain conditions.[114]

The AMA defines "mergers" narrowly; only mergers defined by the Company Act (two companies being assimilated into one) are treated as mergers subject to the prenotification obligation. Business consolidations realized through stock acquisitions, where two parties remain separate legal entities, are not treated as "mergers," and are subject only to an obligation for ex post notification.[115] Commentators have criticized this separate treatment for stock acquisitions as hindering the objective of prenotification; that is, the blocking of anti-competitive business consolidation before consummation. In March 2008, the JFTC and the government announced a bill to be presented to the Diet to amend the AMA to mandate prenotification of stock acquistions for those surpassing certain criteria.[116]

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113 *See* AMA, art. 15(2).

114 *See id.*, art. 15(4), (5).

115 *See id.*, art. 10(2).

116 JFTC, *supra* note 15.

Merging companies and the JFTC have de facto established a system under which merging companies contact the JFTC before filing mandatory prenotifications. In this way companies can get from the JFTC an opinion regarding the legality of the merger, thereby, if necessary, setting up a consultation process about measures to rectify any possible illegal aspects of the proposed merger. This custom has become so well established that the JFTC has to date issued only one formal decision[117] on mergers since the inception of the AMA. Courts have rendered decisions on mergers only during the early period of the AMA: the *Toho/Subaru* and *Toho/Shintoho* decisions.[118] This situation has allowed the JFTC to block or remedy mergers at the consultation stage without having to demonstrate a rigorous proof of market power.[119]

The JFTC now considers unofficial consultations as quasi-official and has been publishing on its Web site the major elements of consultation cases. Moreover, in 2002 the JFTC increased the transparency of such consultations by publishing how the JFTC treats consultation requests; for example, the JFTC's reply is made within ninety days from the date of a request.[120]

When the JFTC considers that a merger about which it is consulted will give rise to market power ("substantial restraint of competition"), the JFTC advises the merging companies to rectify the situation. In most such cases, the consulting companies present remedies (e.g., sale of part of a merged entity), and the JFTC then allows the merger to be completed. In some cases, after receiving negative comments from the JFTC, merging companies have given up the proposed merger.

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[117] Yawata/Fuji (Nippon Steel), 16 SHINKETSUSHU 46 (FTC, Jan. 30, 1969).

[118] Toho/Subaru, 4(14) KOUSAI MINSHU 497 (Tokyo High Ct., Sept. 19, 1951) and Toho/Shintoho, 6(13) KOUSAI MINSHU 868 (Tokyo High Ct., Dec. 9, 1953).

[119] By contrast, the Court of First Instance in the EU demanded that the European Commission present rigorous proof for oligopolistic coordination in *Airtours*, Case T-342/99, Airtours plc v. Comm'n, 2002 E.C.R. II-2585 and subsequent cases.

[120] *See* JFTC, *Policies Dealing with Prior Consultation Regarding Business Combination Plans* (Dec. 11, 2002, amended Jan. 8, 2006 & Mar. 28, 2007), *available at* http://www.jftc.go.jp/e-page/legislation/ama/MApriorconsultation.pdf).

The contents of consultations published by the JFTC do not explain the details of legal issues such as market delineation and identification of market power. Therefore, the lack of merger decisions by the JFTC and the courts has resulted in a lack of cumulative improvements in merger regulation. It is desirable that the JFTC bring important mergers into the formal decision procedures and so make available more detailed discussions of legal issues, even if the merging parties prefer unofficial consultations.

B. Market power test

The JFTC's regulation standards for mergers are explained in its Business Combination Guidelines.[121] In the Business Combination Guidelines, the JFTC has adopted the same market power test as that adopted by the United States and the EU. The AMA itself sets out that mergers (including business combinations through stock acquisitions) are blocked when "the effect of the merger may be substantially to restrain competition in a particular field of trade."[122] "Substantial restraint of competition" has been interpreted by the JFTC and the courts as the power to substantially influence price and other market conditions.[123] This is, in essence, the same as the market power that is worthy of merger regulation under the U.S. Horizontal Merger Guidelines.[124]

The Business Combination Guidelines show that Japanese merger regulation has converged with that of the U.S. and EU merger guidelines under which mergers are blocked when they give rise to market power: unilateral market power or market power formed through oligopolistic coordination.

1. UNILATERAL MARKET POWER The JFTC has traditionally targeted only the unilateral market power achieved by a merged company. This position was maintained until the 2004 Business Combination Guidelines introduced the concept of market power formed through oligopolistic coordination.

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121 Business Combination Guidelines, *supra* note 5.

122 AMA, arts. 10, 15.

123 *Toho/Subaru*, 4 (14) KOUSAI MINSHU at 518.

124 Horizontal Merger Guidelines, *supra* note 43.

Before 2004, the JFTC had not acknowledged that a merger created market power, so long as a competitor, even one with just a small market share, remained in the market. In *Yawata/Fuji (Nippon Steel)*,[125] the JFTC allowed, with minor conditions, a merger that resulted in a market share exceeding ninety percent. This was done on the grounds that steel purchasers were able to resort to "a competitor with effective competitive power," which the JFTC then identified as companies with entry prospects that would be realized by transfers of manufacturing capacity or know-how from the merging companies.

Responding to criticisms regarding the concept of "a competitor with effective competitive power," the JFTC, in its 2007 Business Combination Guidelines (an amendment of the 2004 Guidelines), adopted a more economics-oriented explanation for unilateral market power: When remaining competitors, other than the dominant merged company, have only limited sales or production capacity, those remaining competitors cannot fully meet the increased demand caused by a price increase without increasing their prices; therefore, the merged company obtains the power to unilaterally affect the price of the product.[126] This interpretation of unilateral market power is the same as that adopted in the U.S. and EU merger guidelines and leads to the conclusion of unilateral market power when the merged company obtains a dominant market share. Nevertheless, the 2007 Guidelines do not provide a targeted concentration (HHI) ratio; the Guidelines provide only the safe harbor ratios that are common for unilateral market power and coordinated market power. See part VI.E below.

Within the concept of unilateral market power, the 2007 Guidelines additionally adopted the idea of market power regarding differentiated products. This is an emulation of the idea first presented in the U.S. Horizontal Merger Guidelines.[127] The Japanese 2007 Guidelines explain that when a market is differentiated into different branded products, the company resulting from a merger between companies selling brands of close substitutes, in the absence of companies selling products of equal substitutability, will end up control-

[125] Yawata/Fuji (Nippon Steel), 16 SHINKETSUSHU 46 (FTC, Jan. 30, 1969).

[126] Business Combination Guidelines, *supra* note 5, at §IV.4(1).

[127] *See* Horizontal Merger Guidelines, *supra* note 43, at §2.21.

ling the prices of the products; therefore such horizontal mergers give rise to the "substantial restraint of competition in a market."[128]

The JFTC has yet to deliberate an actual case in which this new concept is applicable. This concept on differentiated products is a convenient way for the JFTC to enlarge the range of cases where unilateral market power can be identified. However, a precise delineation of product markets would render the differentiation concept inutile.[129]

2. COORDINATED MARKET POWER When a merger decreases the number of competitors and substantially increases market concentration, companies in such a market become more likely to engage in coordinated interaction. Such interaction (oligopolistic coordination) includes not only tacit collusion, which is illegal under competition laws, but also implicit coordination (including price leadership) that is not treated as illegal collusion. Oligopolistic interaction harms consumer welfare through a decrease in competition and resulting price rises or decreases in quantity.

Therefore, mergers should be blocked when they give rise to concentrated markets leading to oligopolistic coordination. This idea was first expressed in the U.S. Horizontal Merger Guidelines, and subsequently in the EC 2004 Concentrations Regulation.[130] The JFTC followed suit in its 1998 Business Combinations Guidelines, and further advanced the idea in the 2004 Guidelines (amended in 2007): When a horizontal merger reduces competitors in a market, the concentrated market, together with the characteristics of the product and transaction practices, enables companies to forecast each other's reactions with high precision; therefore, such companies become able to profitably engage in coordinated activities.[131]

In recent consultation cases, the JFTC has increasingly put forth the possibility of oligopolistic coordination as the reason for blocking

[128] Business Combination Guidelines, *supra* note 5, at §IV.1(1)b.

[129] *See* United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1172–73 (N.D. Cal. 2004).

[130] Council Regulation 139/2004, Control of Concentrations between Undertakings, 2004 O.J. (L24/1) 1–22 [hereinafter EC Merger Regulation].

[131] Business Combinations Guidelines, *supra* note 5, at §IV.1(2).

mergers or inducing remedial measures from companies consulting with it. The 2002 consultation case of *JAL (Japan Airline)/JAS (Japan Air System)*[132] concerned the merger of the second and the third largest companies in the Japan airline market. The largest company outside the merger was ANA (All Nippon Airways). Furthermore, in the most profitable air route (Tokyo to and from Fukuoka), there was a newly entered company, Skymark, with just a small market share, that operated alongside the three leading companies. This merger would have reduced the number of competitors from three to two, not including Skymark. The JFTC noted in a published statement that airfares had already been coordinated, and a reduction in number of major competitors from three to two would make price coordination easier.[133] Moreover, it said that new entries are not expected to constrain coordinated behaviors, since such entries would be improbable because of the scarcity of landing slots available at crowded airports.[134] In response to the JFTC statement, the merging companies put up remedial measures, such as a pledge to help new entrants with transfers of landing slots and assistance with airplane maintenance. The merging companies also reduced their airfares on major air routes.[135] Accepting these measures, the JFTC allowed the merger to go ahead.

JAL/JAS is the leading case in which the JFTC applied the concept of oligopolistic coordination to merger regulation. Nevertheless, it is doubtful that the remedial measures were sufficient to alter the merger's anticompetitive nature. In particular, a reduction in airfares exerted no positive effect on competition. The JFTC may have considered the price reduction as a kind of efficiency defense, but it did not give any account of its reasoning. Consultation cases inherently have limits in their explanatory power because the JFTC is not obliged to give a detailed explanation of its legal reasoning.

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[132] JAL (Japan Airline)/JAS (Japan Air System), 2002 NENJI-HOUKOKU (FTC, Apr. 26, 2002), *available at* http://www.jftc.go.jp/e-page/pressreleases/2002/april/020426JJ.pdf.

[133] *Id*. at 2.

[134] *Id*.

[135] *Id*.

Another leading case regarding coordinated market power is *PS Japan/Dianippon Ink*, a 2004 consultation case concerning the consolidation of polystyrene companies.[136] The two companies contemplated combining their manufacturing and sales of polystyrene through business transfers and joint investments. The consolidated company would have become the biggest company, with a more than fifty percent market share. In the consultation, the JFTC noted: (1) companies in the market possessed little unused production capacity; (2) the market was already oligopolistic with three price increases during 2004; and (3) imported quantities had been stable and had little prospect of increase because of the high demand from China.[137] Based on these observations, the JFTC notified the consulting companies of its apprehensions about unilateral market power and coordinated market power. Upon receiving this notice from the JFTC, the consulting companies gave up the proposed business combination. This case is one of a few but increasing number of cases in which the JFTC's negative opinion during the consultation process prompted companies to abandon a proposed merger.

C. *Market delineation*

To identify market power ("substantial restraint of competition" in the AMA terminology) resulting from a merger, the JFTC has relied heavily on the market shares of the merging companies or on the market concentration ratio of the relevant market. Therefore, delineation of a relevant market greatly affects whether or not a merger gives rise to market power and so should be blocked. Delineation of the relevant market is a common crucial factor for important parts of the AMA clauses in which market power is a factor used to determine violations: horizontal agreements (unreasonable restraint of trade), monopolization, and mergers.

1. DEMAND SUBSTITUTABILITY AND THE HYPOTHETICAL MONOPOLIST TEST The JFTC has traditionally delineated a product market by

136 PS Japan/Dainippon Ink, 2002 NENJI-HOUKOKU (FTC, July 21, 2004), *available at* http://www.jftc.go.jp/pressrelease/04.july/04072102.html (Japanese version only).

137 *Id*.

observing the utilities and usage of the relevant product. However, this method has allowed the JFTC to arbitrarily delineate markets. In the 2004 Business Combination Guidelines, the JFTC adopted, together with this traditional method, an economics-oriented method: the so-called hypothetical monopolist test. The revised 2007 Guidelines even more clearly adopted the economics-oriented method.

In its 2007 Business Combination Guidelines, the JFTC explains that a market is mainly delineated from observations of the products' substitutability for consumers.[138] Substitutability between products is assessed as follows: first, the JFTC hypothesizes a monopolist for a certain product; second, the JFTC observes what percentage of consumers would switch their purchases to other products in response to the monopolist's SSNIP. The SSNIP is normally taken as a price increase of five to ten percent during an interval of one year. When the monopolist is able to raise its profit through such price increases, because there are few consumers switching to other products, the product may be regarded as the relevant market for assessing the merger.[139] Delineation of a geographical market is conducted in the same way.

This method for market delineation took as its model the SSNIP test first developed in the U.S. Horizontal Merger Guidelines,[140] and followed in the EC 2004 Notice on Market Definition.[141] Nevertheless, compared to the Horizontal Merger Guidelines, the Business Combination Guidelines' explanation is ambiguous about how a market range is widened or narrowed to reach an optimum. A closer emulation of the Horizontal Merger Guidelines' method, such as successive iterations of the price increase test to determine a market of maximum range, would improve the JFTC Guidelines on market delineation.

The JFTC may have intentionally avoided closely emulating the Horizontal Merger Guidelines' explanation of the hypothetical monopolist test because the theoretical and detailed explanation in the Horizon-

138 *See* Business Combination Guidelines, *supra* note 5, at §II.1.

139 *See id*. at §II.1.

140 Horizontal Merger Guidelines, *supra* note 43.

141 Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law, 1997 O.J. (C 372/5).

tal Merger Guidelines constrains a regulator's latitude in market delineation. Indeed, the JFTC still maintains its traditional method of market delineation (comparison of product utility) on the grounds that substitutability of products, in many cases, coincides with product utility.[142]

2. POSSIBILITY OF GLOBAL MARKETS IN GEOGRAPHICAL MARKET DELINEATIONS A major improvement achieved by the amended 2007 Business Combination Guidelines was that the JFTC admitted, for the first time, that a geographical market may be delineated in a manner to include companies located in foreign countries. This is equivalent to a tolerance of global markets. The 2007 Guidelines explain: "When domestic and foreign consumers have been purchasing a product without discriminating between domestic and foreign suppliers, a price rise in Japan may be suppressed by Japanese consumers' substitution from domestic to foreign suppliers. In this case, a geographical market is delineated as including overseas."[143] In this explanation, "without discriminating between domestic and foreign suppliers" may be best deleted because a small degree of discrimination would not obstruct Japanese consumers' substitution from domestic to foreign suppliers.

Tolerance of geographical markets outside Japan (and possibly global markets) is logically deduced from the hypothetical monopolist/SSNIP test. In spite of this, the 2004 Guidelines, although accepting the reasoning of the SSNIP test, confirmed that geographical markets were restricted to Japanese territories. Thus, import pressure, other than realized imports, was not taken into account for geographical market delineation, but was at the stage of market power assessment. Since the 2007 Guidelines were issued, it has been expected that the JFTC is going to consider global markets for selected manufacturing industries (semiconductors, memory cards, etc.) in which merchandise is freely transacted globally.

3. SUPPLY SIDE CONSIDERATIONS The 2007 Guidelines adopted supply side considerations for the JFTC's market delineation: "The JFTC will consider the possibility that other suppliers are able to switch, within a relatively short period of time (mostly within a year)

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[142] Business Combination Guidelines, *supra* note 5, at §II.2.

[143] *Id.* at §II.3.

and without a substantial amount of additional costs and risks, from the manufacturing and sales of another product or in another region to the product or the region [of merging companies], when a small but significant and non-transitory increase in price is implemented for the product and region. If the degree of such possibility is small, and thus, the monopolist is able to increase its profit through the price rise, the existing product or region would be the area in which the business combination may exert competitive influences."[144]

This direct treatment of supply side substitutability for market delineation is clearer than the indirect treatment in the Horizontal Merger Guidelines, which take into account suppliers' substitutability only in the consideration of the identification of firms that participate in the relevant market.[145] The adoption of suppliers' substitutability, together with the adoption of possible global markets, was effectuated by the JFTC's acceptance of opinions from business associations and the Ministry of Economy, Trade, and Industry (METI), which pressured the JFTC to make its market delineation method more logical and convincing.

D. *Vertical and conglomerate mergers*

The JFTC, in its 2007 Business Combination Guidelines, explains that vertical and conglomerate mergers are assessed first for their exclusionary effects and second for their collusive effects.[146] This viewpoint concides with that of U.S. merger regulations.

The exclusionary effects of vertical or conglomerate mergers are caused by foreclosures emanating from the merger of an upstream company (e.g., a manufacturer) with a downstream company (e.g., a dealer). Collusive effects are caused, for example, when a manufacturer merges with a distributor with the result that the manufacturer becomes able to more easily coordinate with other manufacturers, who deal with the same distributor.[147]

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[144] *Id*. at §II.1.

[145] Horizontal Merger Guidelines, *supra* note 5, at §1.3.

[146] *See* Business Combination Guidelines, *supra* note 5, at §V.

[147] *See id.* at §V.2.

The JFTC has rarely intervened in vertical or conglomerate mergers. In one rare case, the 1993 consultation case of *Oji Paper/ Kanzaki Paper*,[148] the JFTC expressed apprehension about the foreclosure effect resulting from the merged company's stockholding in major distributors.

E. *Safe harbors on concentration ratios*

The Business Combination Guidelines do not provide specific numbers of concentration ratios or market shares beyond which the JFTC is likely to identify market power. The lack of objective numbers as warning signs would have engendered a feeling of uncertainty among businesses. To alleviate this concern, the Business Combination Guidelines provide safe harbors,[149] which are indicated by a combination of post-merger HHIs and incremental HHIs. For horizontal mergers, the safe harbor numbers are: (1) post-merger HHI not more than 1500; (2) post-merger HHI between 1500 and 2500 and the increment of HHI is 250 or less; or (3) post-merger HHI is above 2500, but the increment of HHI is 150 or less.[150]

As a comparison, the safe harbors indicated by the Horizontal Merger Guidelines are: (1) post-merger HHI under 1000; (2) post-merger HHI between 1000 and 1800, and the change in HHI is less than 100; or (3) post-merger HHI above 1800, and the change in HHI

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[148] Oji Paper/ Kanzaki Paper, 1993 NENJI-HOUKOKU (FTC), *available at* http://www.jftc.go.jp/info/nenpou/h05/top_h05.html (Japanese version only).

[149] The Business Combination Guidelines did not adopt the expression of "safe harbor" or "safety area." Nevertheless, the Business Combination Guidelines explained that below the indicated HHI numbers, "it is normally considered that the effect of a horizontal business combination may not be substantially to restrain competition. . . ." Business Combination Guidelines, *supra* note 5, at §IV.1(3). Although this explanation is weaker than the meaning of safe harbor adopted by the U.S. and EU competition authorities, the JFTC will be most unlikely to identify market power (substantial restraint of competition) for mergers not surpassing these HHI numbers.

[150] Business Combination Guidelines, *supra* note 5, at §IV.1(3). The JFTC's safe harbor numbers were considerably raised in the 2007 revision, acceding to requests from METI and business associations, which had demanded that the JFTC provide safe harbors reflecting actual merger regulation practices.

is less than 50.[151] Compared with the U.S. numbers, the JFTC's safe harbor numbers are considerably higher, meaning safety zones are broader. Nevertheless, in the U.S. antitrust situation, actual merger regulation data[152] show that the DOJ and FTC have challenged mergers presenting post-merger HHIs below 1800, but only in a small number of cases (fewer than five percent of all challenged cases).[153] Therefore, in actual practice, the U.S. and Japanese safe harbors within a similar range.

F. *Entry, failing companies, and other factors mitigating market power*

As in the U.S. and EU merger guidelines, the JFTC explains in its Business Combination Guidelines that it takes into consideration the possibility of market entrants in the assessment of market power caused by mergers. Entry conditions are considered together with other factors mitigating market power, such as the increased probability of imports and purchasers' bargaining power.[154]

These mitigating factors are randomly listed in no logical order. There is also no guidance on how they will influence the JFTC's assessment of market power. Particularly ambiguous is how these factors are related to market delineations. For entry considerations, the 2007 Guidelines make no reference to their relationship with market delineation. This may indicate, considering the JFTC's longstanding practice, that the JFTC will not take entry conditions into account at the market delineation stage. In the same way, consideration of the increased possibility of imports, the Guidelines note, is taken into account at the market power assessment stage, but not in the delineation of the geographical market.[155]

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[151] Horizontal Merger Guidelines, *supra* note 43, at §1.51.

[152] *See* FTC & Dep't of Justice, Merger Challenges Data, Fiscal Years 1999–2003 (2003), *available at* http://www.usdoj.gov/atr/public/201898.htm.

[153] *Id.* at table 1.

[154] *See* Business Combination Guidelines, *supra* note 5, at §§ IV.2, 3.

[155] *See id*. at §IV.2 n.7.

A failing company defense is considered to be one of the elements obviating market power. The 2007 Guidelines explain that if one of the merging partners is highly likely to go into liquidation, and at the same time, a less anticompetitive measure than the merger cannot be found, the merger generally will be considered *not* to substantially restrain competition.[156] This explanation regarding a failing company is qualitatively narrower than the generally accepted meaning of the failing company defense, in which an otherwise illegal merger would be tolerated to save a failing company. This narrow stance is appropriate to ensure that saving failing companies is not used as a pretext for anticompetitive mergers.

G. Efficiency considerations

Efficiency considerations in merger regulation have been considerably expanded in competition laws in the United States and the EU. For the ultimate objective of competition law, consumer welfare, mergers achieving market power may be tolerated if they create efficiencies surpassing their anticompetitive effects.

The JFTC has traditionally maintained that merger regulation should exclusively aim to block the creation of market power. This point, legally, rests on the AMA clauses on mergers, which prescribe that mergers ("business combinations") resulting in substantial market power ("substantial restraint of competition") should be blocked. These articles make no reference to efficiencies or the public interest.[157]

However, the JFTC, in its 2004 Guidelines introduced an efficiency consideration for the first time and expanded its explanation in the revised 2007 Guidelines. The Business Combindation Guidelines placed efficiency as one of many elements (including entry and imports) for analyzing market power.[158] Nevertheless, the content of the explanation suggests that the JFTC's consideration of efficiency is

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156 *See id*. at §IV.2(8).

157 *See* AMA, arts. 10, 15.

158 *See* Business Combination Guidelines, *supra* note 5, at §IV.2(7).

equivalent to "efficiency defense."[159] The Business Combination Guidelines' treatment of the efficiency defense is narrower than that of the Horizontal Merger Guidelines and is akin to the EU standard in two respects: (1) accounted efficiencies are limited to those increasing consumer welfare (not including producer surplus) and (2) efficiency considerations would rarely justify a merger resulting in a near monopoly.

This narrow stance on an efficiency defense is appropriate to safeguard consumer welfare. An accumulation of cases is required to determine how the JFTC will allow efficiency defenses.

H. Regulation of economy-wide concentration

As a unique feature of Japanese competition law, the AMA is equipped with a regulation against economy-wide concentration that is separate from merger regulation. This regulation is concerned with economic power across the whole economy and is separate from market power in particular markets. This regulation had historical importance because it was introduced in the original AMA to prevent the revival of the concentrated economic power held by owners of the giant holding companies, known as Zaibatsu, that existed before Japan's defeat in World War II. However, in the period of post-war Japanese economic growth, this regulation has gradually been lessened in weight, as the uniquely Japanese characteristics of economy, such as interlocking stockholdings, have gradually lessened. Moreover, it is theoretically doubtful that control of economy-wide concentration is necessary for a competition policy as well as merger regulation.

The Diet and the JFTC, through legislation and practice have gradually reduced the scope of this regulation. Most notably, the prohibition of pure holding companies (which had formed the core of the economy-wide concentration regulation) was lifted in the 1997 AMA amendment. Currently, regulation of economy-wide concentration is

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[159] The 2007 Guidelines treat efficiency as a procompetitive effect in that an efficiency increase achieved by the merged company may increase the merged company's competitive conduct. Business Combination Guidelines, *supra* note 5, at §IV.2(7).

restricted to (1) regulation of "excessive concentration of economic power,"[160] and (2) regulation of stockholdings by banks and insurance companies.[161] Both clauses are narrowly prescribed, leading to the curtailing of discretionary prohibitions by the JFTC.

First, regulation of "excessive concentration of economic power,"[162] despite its broad title, is restricted to the prohibition of three types of economic power held by "business groups" (parent companies, including holding companies, and their subsidiaries): (1) excessively large business volume held simultaneously in more than five business fields; (2) excessively strong influence held by financial companies over nonfinancial companies, caused by financial relationships; and (3) substantial power in more than five interrelated business fields.

These three types of economic power are prohibited when they exert "large effects on the national economy and impede fair and free competition."[163] Article 9 and its guidelines[164] specifically prescribe the contents of these three types of "excessive concentration of economic power" through descriptions of the amounts of business volume and the numbers of business fields. Thus the JFTC has little discretion in their identification.

Second, article 11, the clause regarding stockholding by banks and insurance companies prohibits financial institutions from holding more than five percent (ten percent in the case of insurance companies) of the voting stocks in any nonfinancial company. The objective of this regulation is to limit the influence of banks and insurance companies on nonfinancial companies. This regulation is similar to the financial regulation enforced in the United States by

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160 AMA, art. 9.

161 *Id.* at art. 11.

162 *Id.* at art. 9.

163 *Id.*

164 JFTC, Guidelines Concerning Companies which Constitute an Excessive Concentration of Economic Power (Nov. 12, 2002), *available at* http://www.jftc.go.jp/e-page/legislation/ama/Company_Concentration.pdf.

financial regulatory agencies. A substantial number of exceptions from this prohibition are prescribed by AMA article 11 and its guidelines.[165]

I. Suggestions for improvement

- It is desirable that the JFTC address important mergers through formal decisionmaking procedures in order to facilitate detailed discussions of legal issues, even if the merging companies prefer unofficial consultations.
- Compared to the Horizontal Merger Guidelines, the Business Combination Guidelines' explanation of the hypothetical monopolist test for market delineation is ambiguous about how a market range is widened or narrowed to reach an optimum. Greater emulation of the Horizontal Merger Guidelines' method, successive iterations of the price increase test to determine a market of maximum range, would accomplish improvements in the Business Combination Guidelines about market delineation.
- The treatment of the efficiency defense in the Business Combination Guidelines is narrower than that of the Horizontal Merger Guidelines and is akin to the EU standard. This narrow stance is appropriate to safeguard consumer welfare. An accumulation of cases is needed to ascertain how the JFTC will consider efficiency defenses.

VII. EXCLUSIONARY (UNILATERAL) CONDUCT

Dominant companies sometimes raise rivals' costs or engage in predatory conduct toward competitors. In many cases, such exclusionary conduct is just hard competition that augments economic efficiencies that benefit consumer welfare. Distinguishing illegal exclusionary conduct from legitimate hard competition is one of the toughest issues facing competition authorities.

In U.S. and EU competition laws, exclusionary conduct, implemented unilaterally, is found to be illegal only when the conduct forms, maintains, or strengthens the market power of the excluding

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[165] JFTC, Guidelines Concerning Authorization of Acquisition and Holding of Voting Rights by Banking and Insurance Companies under the Provisions of Section 11 of the Antimonopoly Act (Nov. 12, 2002), *available at* http://www.jftc.go.jp/e-page/legislation/ama/Bankingstockholding .pdf .

company.[166] This market power requirement,[167] is useful for reducing false positives in the regulation of unilateral conduct because unilateral exclusion is, in many cases, legitimate competition. However, the AMA does not require a finding of market power to condemn unilateral conduct. Therefore, the possibility of false positives is greater under Japanese competition law than under the U.S. or EU competition laws.

Exclusionary conduct is implemented either unilaterally by a single company or in collaboration by more than two companies. Collaborative exclusion may be regulated as a horizontal agreement between competitors.[168] See part IV above. From the viewpoint of minimizing false positives, it is only unilateral exclusion that should be distinguished as a unique field of competition law enforcement.

A. Lack of market power requirement

Under the AMA, exclusionary conduct may be regulated by either article 2(5), the monopolization clause, or article 2(9),

[166] *See*, *e.g.*, U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act 19 (Sept. 2008) ("This monopoly-power requirement serves as an important screen for evaluating single-firm liability."). EU competition law regulates, by article 82, unilateral acts when they amount to "abuse of dominant position." "Dominant position" has been interpreted as the equivalent of market power. *See*, *e.g.*, European Commission, DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses 9 (Dec. 2005) ("According to settled case law, dominance is a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.").

[167] The market power requirement is fulfilled not only when a company already holds market power, but also when a company has the dangerous prospect of being able to acquire market power as a result of exclusionary conduct.

[168] The JFTC has mostly applied the monopolization clause or unfair trade practices clause rather than that related to the horizontal agreement (unreasonable restraint of trade) clause to collaborative exclusionary conduct. For the JFTC, the choice of either clause is of little significance because both clauses require proof of market power, and the sanction is the same.

the unfair trade practices clause. The monopolization clause, modeled after the U.S. Sherman Act section 2, has a market power requirement, but the unfair trade practices clause (see part V above) lacks a market power requirement. Therefore, the JFTC has found it much easier to make use of the unfair trade practices clause rather than the monopolization clause for control of exclusionary conduct.

In the hearing decision of *Microsoft II*[169] about Microsoft's exclusionary conduct toward its competitors (Toshiba, Sony, etc.) in the PC-related audiovisual industry, the JFTC resorted to the unfair trade practices clause in preference to the monopolization clause. By resorting to the unfair trade practices clause, the JFTC avoided the difficult task of identifying Microsoft's market power in the relevant market. In this case, Microsoft forced PC manufacturing companies not to file patent infringement suits against Microsoft with respect to the audiovisual technologies incorporated in Windows. If the relevant market is the audiovisual technology in Windows, Microsoft evidently has market power. On the other hand, Microsoft might not have market power if the relevant market is found to be general audiovisual technology.

In the decision, the JFTC examined the competition restraining effect and compensating reasonableness of Microsoft's conduct regarding the "PC related audiovisual technology" and eventually found that Microsoft had engaged in the illegal unfair trade practice referred to in General Designation section 13 as Dealing on Restrictive Terms.[170] The JFTC rejected Microsoft's argument for the necessity of delineating a relevant market, opining that it is enough to examine the area where licensees' incentive to innovate has been negatively affected, namely "PC-related audiovisual technology."[171]

[169] Microsoft Corp., 55 SHINKETSUSHU (forthcoming) (FTC, Sept. 16 2008) (*Microsoft II*). The original Japanese is available at http://www.jftc.go.jp/pressrelease/08.september/08091801shinketu.pdf. A summary translation in English is available at http://www.jftc.go.jp/e-page/pressreleases/2008/September/080918.pdf.

[170] *Microsoft II*, 55 SHINKETSUSHU, at 2 (English translation).

[171] *Microsoft II*, 55 SHINKETSUSHU, at 96 (original Japanese).

In this finding, the JFTC did not explain whether PC-related audio-visual technology is the relevant antitrust market.[172]

The *Microsoft II* case shows that the unfair trade practices clause applied to unilateral exclusionary conduct enlarges the risk of false positives because the unfair trade practices clause makes it possible for the JFTC to avoid the task of analyzing market power through delineation of a relevant market. Therefore, some limiting principle similar to the market power requirement is necessary for the application of the unfair trade practices clause to exclusionary conduct. The JFTC is aware of this necessity; thus, in its Distribution Guidelines, the JFTC established the "influential position in a market" requirement for the majority of General Designation sections concerning exclusionary conduct. This requirement, although weaker than the market power requirement, requires the JFTC to delineate a relevant market and limits the range of companies that can be found to be engaging in illegal exclusions. See part V.F.3 above.

Nevertheless, General Designation sections 10, with respect to tying, and 15, with respect to obstruction of competitors' business, are left without the "influential position in a market" requirement.[173] Moreover, General Designation section 13, dealing on restrictive terms, although it requires "influential position in a market" for restrictive terms on dealing with competitors, also lacks a requirement for general exclusionary conduct.[174] Therefore, in the *Microsoft II* decision, the JFTC did not require an "influential position in a market" for determining the illegality of Microsoft's restrictive terms.[175]

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172 See *Microsoft II*, 55 SHINKETSUSHU, at 3 (English translation). The JFTC merely opined: "One should take the targeted market for considering this case as the transaction market where innovation incentives are negatively affected, and then, should examine whether fair market order was negatively affected in that market."

173 *See* Distribution Guidelines, *supra* note 45, at part 1, §V.2(2) (tying) & part 3, §III.2(1) (obstruction of competitors' business).

174 *See id*. at part 1, §IV.2 & part 2, §II.2(2).

175 *See Microsoft II*, 55 SHINKETSUSHU, at 4 (English translation) ("Identification of 'unfair trade practices' requires only danger to impede fair competition.").

The reason for these omissions lies in the JFTC's view that these practices fall into the second of the three categories of unfair trade practices, unfairness of competition methods; therefore, they are considered inherently unfair or unreasonable. See part V.B.2 above. However, General Designation section 15, with its wide-ranging expression, may be interpreted to cover almost all exclusionary conduct. Moreover, General Designation section 14, abuse of a superior bargaining position, which the JFTC considers to fall into the third category of unfair trade practices (disruption of fundamentals in free market order), may also be applicable to exclusionary conduct when the conduct is interpreted as such abuse. To reduce the risk of over-intervention into unilateral conduct, it is desirable that the JFTC revise the Distribution Guidelines and add the requirement of "influential position in a market" for General Designation sections 10, 13, 14, and 15.

B. Distinction between legitimate and illegitimate exclusions

Exclusionary conduct, even when it creates or maintains market power ("substantial restraint of competition"), is not automatically illegal under either the monopolization or unfair trade practices clauses. An unreasonable or unjust purpose should be identified in the exclusionary conduct for it to be found illegal.

1. IDENTIFICATION OF UNREASONABLENESS IN EXCLUSION For the monopolization clause, unreasonableness in exclusion has turned on the interpretation of "exclusion" in AMA article 2(5), definition of monopolization.[176] The JFTC has regarded reasonable exclusion as outside the exclusion proscribed in article 2(5). Because of the small number of JFTC decisions (less than one case, annually on average,

[176] The definition of monopolization in AMA article 2(5) includes "control" as well as "exclusion." Most control cases have been about exclusion realized by dominant companies' control of competitors' management. In these control cases, an exclusion clause could also be applied, and thus the control clause is redundant. For some cases, the JFTC has used the control concept to condemn some types of hard core cartels, to which the normal anticartel clause (article 2(6), unreasonable restraint of trade), has been considered not applicable because of the lack of "mutual restriction." *See* part IV.E.1 above.

since 1996 when the JFTC started using the monopolization clause) and, in particular, the scarcity of hearing decisions on monopolization, it is unclear how the JFTC distinguishes legitimate exclusion from illegal exclusion.

In all but two of these monopolization cases, the JFTC did not explain how it identified the unreasonableness of the exclusion, but explained only how the competitors were excluded, resulting in the maintenance or strengthening of market power for excluding companies. In most of these cases, the unreasonableness of exclusion was self evident: for example, abusive and misleading use of a government related product certification system (*Nippon Healthcare Food*[177]) and misleading conduct toward local government officials, fraudulently convincing them to adopt, a product design in which the company's intellectual property is incorporated (*Paramount Bed*[178]).

The JFTC hearing decision in *NTT East*[179] is the first decision in which the JFTC and the defendant exchanged arguments on the reasonableness of an exclusionary practice in a monopolization case. This case concerned a price squeeze in a regulated industry. NTT East operated in both the upstream market (local loop of optical-fiber cable) and the downstream market (optical-fiber based Internet access service) holding dominant shares in both. NTT East set its access fee at a level below its retail price, thus rendering it impossible for competitors in the downstream market to make profits. Nevertheless, NTT East argued that the competitors could reduce the access fee by making more efficient use of the rented optical-fiber line by splitting it for multiple users, in the same way as NTT itself intended to do. NTT East thus contended that its conduct was not unreasonable from the viewpoint of "equality of competitive conditions." However, the JFTC found that NTT itself did not adopt the splitting method because of the small number of customers. Therefore, the JFTC found that the conduct of NTT East was unreasonable.[180]

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177 43 SHINKETSUSHU 209, 212–15 (FTC, May 8, 1996).

178 44 SHINKETSUSHU 362, 364–67 (FTC, Mar. 31, 1998).

179 NTT East, 53 SHINKETSUSHU 776 (FTC, Mar. 26, 2007).

180 *Id*. at 806.

The "equality of competitive conditions" argument is, in essence, equivalent to the "equally efficient competitor test."[181] In two private action unfair trade practice cases concerning exclusionary conduct, the Tokyo High Court also adopted this equally efficient competitor test.[182] These cases show the increasing popularity of the equally efficient competitor test in Japanese legal decisions related to exclusionary conduct. However, this test narrows down the area of illegal exclusion too much and therefore may not be an appropriate test for the whole range of exclusionary conduct.[183]

When the JFTC applies the unfair trade practices clause to exclusionary conduct, the JFTC has examined the reasonableness of the conduct in determining "unjustness" for each of the General Designation sections. In *Microsoft II*[184] where the JFTC applied General Designation section 13, dealing on restrictive terms, it examined the unjustness of the restrictive term—the obligation of licensees not to file patent infringement suits against Microsoft, the licensor, regarding licensees' technologies incorporated in Windows. The JFTC then concluded that the obligation was unjust on the following grounds: first, the obligation allows Microsoft to utilize the licensees' patents royalty-free,[185] and second, this is an unequal obligation with respect to licensees.[186] The JFTC also examined whether the obligation created an exceptionally compensatory benefit and concluded it did not on the grounds that the security of the platform function of Windows

181 *See* RICHARD A. POSNER, ANTITRUST LAW 194 (2d ed. 2001).

182 LP Gas Discriminatory Price, 52 SHINKETSUSHU 818, 826 (Tokyo High Ct., May 31, 2005); Yamato Transp. v. Japan Post, 2006 (Ne) No. 1078, LEX/DB Legal Database No. 28140088 (Tokyo High Ct., Nov. 28, 2007).

183 *See* Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. 147, 154–55 (2005).

184 Microsoft Corp., 55 SHINKETSUSHU (forthcoming) (FTC, Sept. 16 2008) (*Microsoft II*). The original Japanese is available at http://www.jftc.go.jp/pressrelease/08.september/08091801shinketu.pdf. A summary translation in English is available at http://www.jftc.go.jp/e-page/pressreleases/2008/September/080918.pdf.

185 *Microsoft II*, 55 SHINKETSUSHU, at 3 (English translation).

186 *Microsoft II*, 55 SHINKETSUSHU, at 101 (original Japanese).

could be preserved through means other than the obligation not to sue, e.g., an obligation not to invoke the patent-based right to restrict the use of the licensees' patents at issue.[187]

Aside from its deliberations on unjustness, the JFTC deliberated on the obligation's effect on the licensees' incentive to innovate in accordance with the IP Guidelines, which state that the obligation not to sue regarding licensees' patents constitutes an illegal unfair trade practice when the obligation undermines licensees' incentive to innovate, thus impeding development of new technologies.[188] The JFTC concluded that the licensees'obligation in *Microsoft II* could be presumed to negatively affect innovation incentives, even if PC-related audio-visual technologies may be utilized in the broader audio-visual appliance market.[189]

The distinction between legitimate and illegitimate exclusion still remains ambiguous. It is desirable that the JFTC present new guidelines on exclusionary conduct that will explain how illegitimate exclusion is distinguished from legitimate exclusion under both the monopolization and unfair trade practice clauses.

2. EXCLUSIVE DEALING AND REBATES The JFTC has usually applied the unfair trade practices clause to exclusive dealing. See part V.F.3 above. However, in recent years, the JFTC has started to apply the monopolization clause to exclusive dealing as well.

U.S. and EU competition laws show that exclusive dealing and similar market foreclosing conduct are scrutinized for: (1) the degree of market foreclosure to rivals and (2) the efficiency defense. In Japan, for monopolization cases,[190] degree of market foreclosure has never been discussed by the JFTC, which may have considered that exclusive dealing by a dominant company invariably exerts enough foreclosure effect to be identified as monopolization. Neither has the efficiency defense been discussed in monopolization cases because

[187] *Microsoft II*, 55 SHINKETSUSHU, at 5 (English translation).

[188] *See* IP Guidelines, *supra* note 40, at §IV.5(6).

[189] *Microsoft II*, 55 SHINKETSUSHU, at 4 (English translation).

[190] For application of the unfair trade practices clause to exclusive dealing, see *supra* part V.F.3.a.

the dominant companies have simply accepted JFTC recommendations without asserting defenses.

Two JFTC decisions among the monopolization cases concerned exclusive dealing. First, in *M.D.S. Nordion*,[191] the JFTC found illegal monopolization in an exclusive dealing arrangement imposed by a dominant Canadian company on Japanese and other foreign companies. The Canadian company was dominant in the worldwide molybdenum product market. The JFTC may now consider it preferable to apply the monopolization clause, rather than the unfair trade practices clause, to exclusive dealing conducted by dominant companies. The second decision is *Nipro*,[192] in which a dominant manufacturer of ampoules (glass containers for medicine) harassed one of its sole distributors that had started to import from a foreign manufacturer. This is, in essence, an exclusive dealing case, although the JFTC identified the excluded competitor as the harassed distributor, not the foreign manufacturer.[193]

The JFTC's *Intel* decision[194] concerned a rebating tactic adopted by Intel. The Japanese subsidiary of Intel (Intel Japan) had a nearly ninety percent share of the Japanese microprocessor market. Its main rival, Advanced Micro Devices (AMD), had been increasing its market share. Intel Japan, to preserve its dominant market share, adopted a rebating system in which rebates were given only to those PC manufacturers who purchased at least ninety percent of the microprocessors they used from Intel Japan. Responding to this rebating scheme, the PC manufacturers maintained the level of at least ninety percent of their purchases from Intel. Moreover, some manufactures terminated their purchases from AMD and switched to Intel. The JFTC found this rebating system to be exclusion in violation of the monopolization clause.[195] Whether there was an efficiency defense for the

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191 45 Shinketsushu 148 (FTC, Sept. 3, 1998).

192 53 Shinketsushu 195 (FTC, June 5, 2006).

193 *Id*. at 235–36.

194 52 Shinketsushu 341 (FTC, Apr. 13 2005).

195 *Id*. at 347. After the JFTC decision, Advanced Micro Devices filed a damage recovery suit, which is now going through the Tokyo Regional Court.

rebating system was not discussed because Intel simply accepted the JFTC recommendation. See part II.C.2.a above. The JFTC treated this rebate as a market foreclosure measure, rather than predatory pricing. In this regard, this decision presents a viewpoint that is in common with that of the U.S. Third Circuit in its *LePage*'s decision.[196]

3. PREDATORY PRICING AND PRICE DIFFERENTIATION

a. Predatory pricing The setting of unreasonably low prices by a dominant company for the purpose of excluding rivals is called "predatory pricing." Under U.S. and EU competition laws, the main issues regarding predatory pricing have been (1) the selection of the benchmark cost for identifying a presumptively illegal low price (average variable cost, avoidable cost, or average total cost) and (2) the identification of market power or dominant position in the company engaging in the predatory pricing.

Under the AMA, predatory pricing can be regulated by either the monopolization clause or the unfair trade practices clause. In practice, the JFTC has exclusively applied the unfair trade practices clause to predatory pricing. General Designation section 6 on unfair trade practices explains that two types of low prices are illegal "unjust low price sales": (1) nontemporary sales of products at prices greatly below the cost of supplying them; and (2) other sales at unduly low prices. The definition of the second type of low prices is vague, potentially covering prices above cost. However, the Tokyo High Court in *Yamato Transport*[197] opined that "unduly low prices" should not include, from the view of competition on the merits, prices surpassing "the cost of supplying products."

Both types of low prices are illegal when they are found to "have the danger to cause difficulties to the business of competitors," without "proper justification."[198]

On the first of the universal issues regarding predatory pricing, the selection of the benchmark cost, General Designation section 6

[196] LePage's Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003).

[197] Yamato Transp. v. Japan Post, 2006 (Ne) No. 1078, LEX/DB Legal Database No. 28140088 (Tokyo High Ct., Nov. 28, 2007).

[198] General Designation, *supra* note 73, at §6.

clearly takes it as the average total cost. Nevertheless, the low price should be either greatly below cost or an unreasonably low price. All of the JFTC decisions on unreasonably low prices have concerned retailing businesses. In the recent remedy order case of *Hamaguchi Petroleum*,[199] the JFTC interpreted both types of low prices in conjunction and condemned the low pricing by a dominant gas station operator. The operator priced its gas below the combined costs of the purchase price and sales expenses. This case showed that the JFTC has not chosen to apply the Areeda-Turner test adopted by the U.S. courts that never finds prices above incremental cost (measured by average variable cost) as illegal. The current position of the JFTC is similar to that of the European Commission, which can find a price below average total cost (but above average variable cost) illegal, when intent to harm competitors is found.

As a guide to General Designation section 6, the JFTC published the Guidelines on Unfair Price Cutting.[200] The coverage of these Guidelines is limited to retail businesses, and the Guidelines state that "prices greatly below supply cost" as expressed in General Designation section 6 normally signify retail prices below purchase (wholesale) prices.[201] This standard was basically sustained by the Tokyo Regional Court in its *Daikoku* decision,[202] a private action case. Nevertheless, the Court elaborated that the actual wholesale price should be calculated by taking into account rebates, thus rejecting the argument put forth by the appellant that administrative and sales costs should be added to the wholesale price. In this decision, the court took the benchmark cost as a combination of purchase cost and sales cost. Thus this decision is at odds with the JFTC *Hamaguchi Petroleum* remedy order.

The *Daikoku* decision also held that discounted sales implemented for twenty days are considered neither "nontemporary" nor as posing

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[199] 53 SHINKETSUSHU 867–68 (FTC, May 16, 2006).

[200] JFTC, Guidelines Concerning Unfair Price Cutting under the Antimonopoly Act (Nov. 20, 1984), *available at* http://www.jftc.go.jp/e-page/legislation/ama/pricecutting.pdf.

[201] *Id*. at §3(1).

[202] Case No. 2002 (Ne) 1413 LEX/DB Legal Database No. 28092569 (Sept. 29, 2004).

"danger to cause difficulties to the business of competitors." A comparison of the *Hamaguchi Petroleum* and *Daikoku* cases shows that the Tokyo Regional Court identified illegal low pricing more narrowly than did the JFTC.

The JFTC has issued no decisions for manufacturing industries, but it has issued warnings against Fujitsu in 1990 and Hitachi in 2001 on their exceedingly low offers (nearly zero yen) on software systems to local governments. However, the JFTC has not explained how "prices greatly below supply cost," as specified in General Designation section 6 are identified for manufacturers.

In the parcel delivery industry, the Tokyo High Court issued the *Yamato Transport* decision,[203] a private injunction suit filed by the largest parcel delivery company against the government-owned Post and Savings Corporation (Japan Post), which had newly entered into the commercial parcel delivery business. The High Court denied the claim of illegal low pricing by Japan Post on the grounds that the plaintiff could not prove that defendant's parcel prices were below total sales cost. The High Court rejected the assertion by the plaintiff that Japan Post's costs in commercial parcel delivery should be calculated on a stand-alone basis separated from Japan Post's regulated postal delivery. The High Court opined that it is economically rational for an enterprise, when it enters into new business, to make use of the resources in its existing businesses.

b. Price discrimination Price discrimination under the U.S. Sherman Act is regulated as predatory pricing; thus it is found illegal only if it is deemed to be illegal predatory pricing. There is almost a consensus among economists that price discrimination does not inherently decrease consumer welfare,[204] so that it does not deserve regulation separate from predatory pricing. By contrast, in Japan, under the General Designation on unfair trade practices, price discrimination is

[203] Yamato Transp. v. Japan Post, 2006 (Ne) No. 1078, LEX/DB Legal Database No. 28140088 (Tokyo Hight Ct., Nov. 28, 2007).

[204] *See, e.g.*, Dennis W. Carlton, *Does Antitrust Need to be Modernized?* 13 (Economic Analysis Group Discussion Paper, U.S. Dep't of Justice, 2007), *available at* http://www.usdoj.gov/atr/public/eag/221242.pdf ("[T]he better the discrimination, the more likely efficiency will increase.").

treated as "unjustly low pricing," a category distinct from predatory pricing.

Illegal price discrimination is described in General Designation section 3: "Unjustly supplying or accepting a commodity or service at prices which discriminate between regions or between transaction partners." This description presents no standard for identifying unjust or unreasonable discrimination. Compared to General Designation section 6 for unjustly low pricing, section 3 lacks the limiting principle that illegal discrimination should have "danger to cause difficulties to the business of competitors." This lack of a limiting principle indicates that the JFTC may find price discrimination illegal even if the pricing causes no exclusionary effects. Nevertheless, the JFTC has so far found that the exclusionary effects of price discrimination constitute an anticompetitive effect under AMA article 2(9).

Most of the JFTC's General Designation section 3 cases have concerned price discrimination that companies used as a device to implement other illegal practices, such as price cartels, resale price maintenance, and group boycotts. The JFTC, logically, should have considered these cases as primary violations and not as cases of price discrimination.

Only two JFTC decisions are genuinely price discrimination. First is the Tokyo High Court's decision in *Hokkoku Newspaper*.[205] In this case, the JFTC treated price discrimination as exclusionary conduct, finding that the price difference between 330 yen and 280 yen, implemented by Yomiuri, the largest national paper, between neighboring prefectures posed the a danger of robbing customers from Hokkoku, a competing regional newspaper company. The Tokyo High Court accepted the JFTC's request for a preliminary injunction, but did not present an opinion regarding the standard by which to identify unreasonable price discrimination.

Second, and the most recent of the JFTC decisions on price discrimination, is the *Yusen BroadNetworks* decision.[206] In this case, Yusen BroadNetworks Co., the largest operator in the market of "musical

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205 8 SHINKETSUSHU 82 (Tokyo High Ct., Mar. 18, 1957).

206 51 SHINKETSUSHU 518 (FTC, Oct. 13, 2004).

cable radio broadcasting for businesses" selectively reduced its price to customers of its largest competitor and induced a large number of such customers to switch from the competitor to Yusen. The JFTC condemned the selective price reduction as illegal monopolization under AMA article 2(5). The defendant did not object to the JFTC recommendation; therefore the JFTC did not explain whether selective price reduction by a dominant company is always illegal.

At variance with the JFTC decisions, a recent Tokyo Regional Court decision on a private injunction suit opined that price discrimination needed to amount to illegal predatory pricing for it to be found illegal. In this decision, *LP Gas Discriminatory Price (Nippon Gas Co.)*,[207] the court held that price discrimination is illegal when the seller's pricing tactics are such that equally or more efficient competitors are not able to survive in the market. This viewpoint is equivalent to the "equally efficient competitor test" advocated by Judge Posner[208] and other commentators in the United States. Based on this test, the court denied the existence of undue discriminatory pricing because the defendant's prices covered its costs.

The *LP Gas Discriminatory Price* decision presents a more rational standard for price discrimination than the JFTC decisions, in that price discrimination is scrutinized as predatory pricing. It is desirable that the JFTC adopt this position.

C. *Remedies and sanctions*

Remedies for violation of the monopolization clause are broadly set out: the JFTC is entitled to order a violating company to cease and desist from the conduct, to transfer part of its business, or to take any other measures necessary to eliminate the violation.[209] In the United States, antitrust agencies have, in a few cases, resorted to structural remedies, such as the breaking up of AT&T, the most noteworthy example. By contrast, the JFTC has limited its remedies to cease-and-desist orders. For structural remedies, the Diet has passed special legislation. See part VII.D below.

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207 52 SHINKETSUSHU 818, 826 (Tokyo High Ct., May 31, 2005).

208 POSNER, *supra* note 181.

209 *See* AMA, art. 7(1).

For unfair trade practice clause violations, remedies are also broadly set out: the JFTC may order any measures necessary to eliminate the violation.[210] Moreover, a private action suit seeking an injunction is allowed against violators of the unfair trade practice clause (but not allowed against monopolizations). See part II.F above.

Criminal penalties may be levied on violators of the monopolization clause.[211] Nevertheless, the JFTC has never made a request for criminal penalties against monopolization clause violators. This situation is the same as in U.S. antitrust law enforcement. The lack of criminal penalty enforcement in Japan and the United States may be explained by the fact that monopolists (excepting "control" cases applied to hard-core cartels) are devoid of an evidently wrongful character that can be easily identified in hard-core cartels.

Surcharges may currently *not* be levied on violators of either the monopolization or unfair trade practice clauses. However, a Cabinet Office Report recommended that administrative surcharges be newly levied with respect to violations of the monopolization clause, as well as with respect to selected violations of the unfair trade practices clause. Then, in March 2008, the JFTC and the government announced a bill to be presented to the Diet to partially amend the AMA.[212] The bill introduces administrative surcharges on monopolization as well as on selected types of illegal unfair trade practices.[213] Nevertheless, the standards to identify illegal conduct regarding monopolization, as well as unfair trade practices, have remained ambiguous. Therefore, levying surcharges on violators of these clauses would increase the feeling of uncertainty for companies. This would work to blunt companies' willingness to engage in vigorous competition.

D. Special provision to dissolve "monopolistic situations"

Another unique feature of Japanese competition law, in addition to the regulation of economy-wide concentration (see part VI.H above),

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[210] *See id.* at art. 20(1).

[211] *See id.* at art. 89.

[212] JFTC, *supra* note 15.

[213] *See supra* part V.B.3.

is that the AMA has a special provision allowing structural measures against monopolistic companies. This provision is not a remedy for illegal monopolization, but a pure structural measure aimed at breaking up dominant companies. Where a "monopolistic situation" is found to exist in an industry, the JFTC may order the monopolistic company to transfer part of its business or implement other measures to restore competition in the market.[214] A "monopolistic situation" is described through a combination of high market share (a single company's share of more than fifty percent or two companies' combined market share of more than seventy-five percent) and oligopolistic behaviors such as inflexible prices and extremely high profits in a market surpassing 100 billion yen for domestic suppliers.[215]

This provision, added by the 1977 AMA revision, was influenced by the proponents of structural measures in the United States during the 1970s. Nevertheless, because of compromises during the legislative stage in the Diet, rigorous conditions were attached to implementing structural measures. A particularly difficult condition is the necessity to consult with the relevant economic ministries.[216] The JFTC, therefore, has never applied this provision and may indeed have little intention if applying it in the future. In 2003, however, the JFTC established a study group that aimed to replace this provision with a new one targeting essential facilities in oligopolistic markets.[217] However, this endeavor stalled because of opposition from academic and business circles that questioned the relevancy of the new provision on grounds that essential facilities may be addressed by existing AMA provisions on monopolization and unfair trade practices.

This provision has a unique standing among competition laws worldwide as it provides for a pure structural measure against monopolistic companies. However, the current provision has only an orna-

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[214] *See* AMA, arts. 27-2 & 8-4.

[215] *See id.* at art. 2(7).

[216] *See id.* at art. 46.

[217] *See* Press Release, JFTC, Outlines of the Amendment of the Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade (Dec. 24, 2003), *available at* http://www.jftc.go.jp/e-page/pressreleases/2003/december/031224Outlines.pdf.

mental significance because its rigorous conditions make it practically impossible for the JFTC to implement any structural measures. On the other hand, pure structural measures, could they be easily implemented, have the risk of blunting companies' incentives for growth. The JFTC is capable of implementing structural measures as remedies against illegal monopolization, although it has never resorted to them. It is desirable that the JFTC make an announcement that it is prepared to resort to structural remedies against monopolization and then abolish articles 27-2 and 8-4 against "monopolistic situations."

E. Suggestions for improvement

- To reduce the risk of overintervention in unilateral conduct, it is desirable that the JFTC revise its Distribution Guidelines and add a requirement of "influential position in a market" for General Designation sections 10, 13, 14, and 15.
- It is desirable that the JFTC set up new guidelines on exclusionary conduct that will explain how illegal exclusion is distinguished from legitimate exclusion under both the monopolization and unfair trade practice clauses.
- It is desirable that the JFTC treat price discrimination as predatory pricing and that it adopt a common standard on unduly low pricing and price discrimination.
- It is desirable that the JFTC make an announcement that it is prepared to resort to structural remedies against illegal monopolization and then abolish the articles against "monopolistic situations."

VIII. CONCLUSIONS

The AMA, in its sixty-year history, has accomplished gradual improvements through decisions by the JFTC and the courts. However, at the same time, AMA standards have become too complicated, largely due to the parallel application of the standard antitrust concepts (restraint of trade and monopolization) and the uniquely Japanese concept of unfair trade practices. It is clearly necessary to update the regulation of unfair trade practices to a modern interpretation, one that reflects economic realities, through studying the legal systems at play in other leading economic zones, the United States and the EU in particular.

Merger regulation has essentially converged between the United States, the EU, and Japan. This convergence highlights the power of economic analysis. The essential nature of economic reasoning has commonality among market economies. Therefore, the adoption of economics-oriented standards leads to common competition law standards among different countries and market zones.

Sanctions against violations have been considerably strengthened through increases in the amount of surcharges levied. Strengthening sanctions against hard-core cartels remains necessary, and further increases in the amount of surcharges appear appropriate. But, extending surcharges to areas outside hard-core cartels, a move now being contemplated, is not advisable because such an extension would lead to a deterrence of vigorous competitive conduct. Instead of extending sanctions, encouragement should be given to facilitating suits for recovery of damages, particularly by allowing class actions to be lodged with the courts.

The Lion City and the Fragrant Harbor: The political economy of competition policy in Singapore and Hong Kong compared

BY MARK WILLIAMS*

I. INTRODUCTION

Hong Kong and Singapore are recent converts to the notion that an antitrust regime is an important part of the necessary regulatory structure underpinning a contemporary economy. Singapore enacted a general competition law in 2004.[1] Although the Hong Kong government was committed to legislate by the end of 2009, action has been delayed ostensibly as a result of unexplained "technical issues."[2]

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AUTHOR'S NOTE: *"Fragrant Harbor" is the translation of the traditional Chinese name*—Heung Gong *(Cantonese) or* Xianggang *(Mandarin)—for Hong Kong. "Lion City' is the translation of the original Sanskrit name for Singapore:* "singa"—*lion* and "pura"—*city.*

[1] Competition Act 2004 (Oct. 19, 2004), *available at* http://www.singaporelaw.sg/content/CompetitionLaw.html.

[2] 2007–08 Policy Address, A New Direction for Hong Kong ¶¶ 32–33 (Oct. 10, 2007), *available at* http://www.policyaddress.gov.hk/07-08/eng/docs/policy.pdf. *But see Technical Issues Put Competition Bill on hold*, SO. CHINA MORNING POST, Feb. 28, 2009, at 28, *available at* http://archive.scmp.com/showarticles.php.

These two Far Eastern enclaves of capitalism have much in common, but they also display significant differences in terms of economic and political structures, which have a profound effect on competitive conditions in their domestic markets. I argue that the political economy of Singapore and Hong Kong have been the cause of both cities' slow acceptance of the need for procompetition legislation. This marked reluctance to introduce antitrust laws has also had consequences for the design of the new Singapore regime and the creation of the putative Hong Kong scheme. Political economy considerations will also have a significant impact on the likely vigor of implementation, especially when existing industrial structure is the underlying cause of competition impediments. Inevitably, the observations made in this article are tentative as the Singapore law has been in force for only two years and the Hong Kong regime is still being constructed; thus to an extent, this article could be characterized as speculative, but I suggest that careful examination of the nature of these two city-states supports the hypothesis I advance.

This article will attempt to describe the similarities and differences between the two cities in terms of their respective histories, political arrangements, and economic models. Once these issues have been considered, the article will explain and analyze the development of their respective competition policies. Implementation of these policies will then be assessed. Finally, an attempt will be made to predict the future development of their new procompetition regimes, given the political economy landscape within which each system will operate. Some concluding thoughts will then be offered on the likely impact of the adoption of procompetition policies on the domestic economies of Singapore and Hong Kong. The significance of this article lies in the fact that these two small jurisdictions have a substantially greater global economic importance than their minuscule geographical extent would at first suggest.

II. HISTORY, POLITICS AND ECONOMIC STRUCTURE OF SINGAPORE

A. History

Singapore is an island of 271 square miles (about 20% smaller than the land area of New York City).[3] The topography is benign with the highest point only 300 feet above sea level. Singapore is just north of the equator and is sandwiched between the Indonesian island of Sumatra and the Malayan peninsula. The population is approximately 4.6 million of which 76% are ethnically Chinese, 14% Malay, and 8% Indian.[4]

The modern history of Singapore began in 1819, when Sir Stamford Raffles established a trading post on the island. Raffles was an officer in the armed forces of the British East India Company and was Lieutenant-Governor of Bencoolen (Sumatra), from which the Dutch had been expelled by the British as the Netherlands was an ally of France in the Napoleonic Wars. As part of the Congress of Vienna peace settlement, the Dutch regained control of their East Indies empire. Raffles appreciated that the tip of the Malayan Peninsula was a focal point for multiple shipping routes between Europe, India, and the Far East, as well as being a hub for regional trade. He was convinced that occupation of this strategic site was vitally important to British economic and imperial interests, especially to secure the route taken by East India Company ships trading opium from Bengal to China and returning with tea, silk, and porcelain. Furthermore, the restrictive trade regime and high tax policy of the Dutch stifled trade, and Raffles believed that Singapore would provide the ideal location for the establishment of a new trading base that would prosper as a free port. Formally annexed by the British and recognized by the Dutch in 1824, Singapore became part of the British Straits Settlements of Penang and Malacca in 1826. Later this entity was freed

[3] New York City Dep't of City Planning, New York City Land Use, *available at* http://nyc.gov/html/dcp/html/landusefacts/landusefactshome.shtml (last visited Aug. 13, 2009).

[4] Singapore Dep't of Statistics, Resident Population Profile 2008, *available at* http://www.singstat.gov.sg/stats/keyind.html#respop (last visited Aug. 13, 2009).

from the administrative control of the British Indian Raj and became a separate Crown Colony answerable directly to the Colonial Office in London. Singapore rapidly became the major trading and shipping center for the India-China trade and an entrepôt for South East Asia.[5]

A key economic decision taken by Raffles was to designate Singapore a free port, and this caused a rapid influx of immigrant Malay, Chinese, and Arab traders. The invention of steam ships, the opening of China to foreign trade from the 1840s, the completion of the Suez Canal in 1869, and the development of rubber plantations in the Malayan Peninsula later in the 19th century all greatly increased Singapore's economic importance. The South East Asian Chinese diaspora and an influx of Chinese immigrants from civil war and economic dislocation in China in the latter half of the 19th century created the ethnic predominance of the Chinese that has continued to this day.

In the 1920s, the British colonial administration became concerned about Imperial Japan's expansionist ambitions and so built large naval and air bases as a defensive measure. However, in the worst British military defeat of World War II, Singapore was surrendered to the Japanese in January 1942. This capitulation had profound implications for the continuation of British imperial ambitions. Post-war, Singapore was granted limited representative government, which was expanded in the 1950s, but the evolution to self-government was complicated by a communist insurgency that attempted to foment violent revolution in the whole Malayan Peninsula. In 1959, full internal autonomy was granted and in the subsequent general election the People's Action Party (PAP), headed by Lee Kuan Yew, took power.[6]

The 1960s were politically unstable in South East Asia. Peninsula Malaya became independent in 1957, but by the early 1960s the Singapore and the Malay authorities were convinced that federation between themselves and the separate British colonies of North Borneo was politically, militarily, and economically essential. The Federation of Malaysia was created in 1963 but lasted only two years. Internal ideological disagreements, external meddling by a militantly nationalistic Indonesia and complex racial politics ensured the demise of the ill-

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[5] A History of Singapore (Ernest C.T. Chew & Edwin Lee eds. 1991).

[6] *Id.*

fated Federation. Singapore became an independent republic in 1965. Threatened militarily by the Indonesian *Konfrontasi* (confrontation) policy and by hostility from a resentful faction of the Malaysian government, Singapore's viability was questionable, given its small population, geographical extent, and the absence of natural resources.[7]

B. Political Structure and Institutions

Despite an inauspicious birth, Singapore has endured and prospered as a parliamentary republic with a unicameral legislature in which the PAP won eighty-two of eighty-four seats in the last general election in 2006. PAP has been in office for forty-nine years since independence from Britain and continues to dominate the political environment. Its electoral popularity has declined significantly in the last fifteen years, however, so that it enjoyed only sixty-six percent of the popular vote in the last general election.[8]

Government is considered to be efficient and well-organized, and Singapore scores highly in anticorruption indices, ranking 4th out of the 180 countries surveyed by Transparency International in 2008.[9] The judiciary has a good reputation for the equitable and efficient disposal of commercial disputes. Singapore continues to operate a common law system derived from English law. Criticism has been made of various aspects of Singapore's "liberalism" and in particular the regular use of capital and corporal punishment, the availability of detention without trial for political offenses, the existence and use of restrictive censorship laws, the significant limitations imposed on freedom of assembly, and the use of broad libel laws to quash dissent or political criticism.[10]

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[7] *See* LEE KUAN YEW, FROM THIRD WORLD TO FIRST: THE SINGAPORE STORY *1965–2000*, at 49–70 (2000).

[8] *See* U.S. Dep't of State, Background Note: Singapore (May 2009), http://www.state.gov/r/pa/ei/bgn/2798.htm# (last visited Aug. 13, 2009).

[9] *See* Transparency International, Corruption Perceptions Index, *available at* http://www.transparency.org/news_room/in_focus/2008/cpi_2008_table.

[10] In 2009, Freedom House ranked Singapore as "partly free" as a result of these limitations on civil and political liberty. *See* Freedom House, Country Report, http://www.freedomhouse.org/template.cfm?page=363&year=2009&country=7700.

C. Economy

Singapore's strategic location gives it an economic significance that is disproportionate to its geographic size and population, being at the intersection of major international and regional trade routes. In 2007, services made up sixty-four percent of the economy, with financial and business services being the largest segment followed by the transportation sector. Manufacturing accounted for twenty-six percent of the economy, of which electronics and chemicals/petrochemicals formed the largest components. Singapore's gross domestic product per capita on a purchasing power parity basis was $48,900. Malaysia, the United States, Hong Kong, China, Indonesia, and Japan are Singapore's largest trade partners. Singapore is an open trading economy and has received large quantities of foreign direct investment. As of 2005, North America and Asia were major contributors in Singapore industries, largely concentrated in manufacturing, financial and insurance services, and wholesale and retail trade. These three major areas contributed to over eighty-two percent of foreign direct investment stock in Singapore.[11]

In recent times, Singapore has suffered from the fallout of the Asian financial crisis of 1998–1999, the bursting of the dot-com bubble in 2001, and the effects of the SARS epidemic in 2003. Despite these setbacks, the economy has been growing robustly in recent years with a growth rate of 7.5% in 2007.[12] However, Singapore has been seriously affected by the ongoing financial crisis with a severe contraction of its economy of six to nine percent in 2008–09.[13] Singapore has also attempted to diversify away from electronics into biomedical sciences and to develop itself as a regional hub for financial services, education,

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[11] *See* Statistics Singapore Newsletter 1, 4 (Sept. 2007) *available at* http://www.singstat.gov.sg/pubn/papers/economy/ssnsep07-pg1-6.pdf. For data regarding the United Kingdom, see Foreign and Commonwealth Office, Singapore, *available at* http://www.fco.gov.uk/en/about-the-fco/country-profiles/asia-oceania/singapore?profile=all (follow Trade and Investment) (last visited Aug. 13, 2009).

[12] *See, e.g.*, S. Ramesh, *Singapore's Economy Grows 7.5% in 2007: P. M. Lee*, CHANNEL NEWSASIA, Dec. 31, 2007.

[13] Shamin Adam & Andrea Tan, *Singapore Economy May Contract by Record 9% as Exports Collapse*, BLOOMBERG.COM, Apr. 14, 2009, http://www.bloomberg.com/apps/news?pid=20601080&sid=aulnAGmrjuhk&refer=asia.

medical services, and leisure. Policies to boost technological innovation funded by the public sector have been implemented.[14] In 2005, the government announced the licensing of two large casino complexes, reversing a longstanding ban on the promotion of gambling. This was politically controversial and was probably in response to the phenomenal success of the liberalized gaming market in Macau. Casinos will supplement Singapore's ambition to consolidate its leisure industry.[15]

In 2003, Singapore entered into a free trade agreement with the United States to bolster its trade relations, one of the terms of which was a commitment by Singapore to enact a comprehensive antitrust law.[16] Shortly afterwards, another free trade agreement was signed with Australia which contained a similar requirement.[17]

1. STATE-GUIDED ECONOMIC DEVELOPMENT Since independence in 1965, economic development in Singapore has been heavily guided by the state. Foreign investment, to establish export processing factories especially in the electronics and petrochemical sectors, has been eagerly sought for many years and supported by the government through a range of policy incentives.[18] Singapore features regularly at the top of rankings of business-friendly locations.[19] The open attitude to foreign

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[14] *See* Dr. Vivian Balakrishnan, Speech at the Opening Ceremony of Electronic Arts Asia Pacific's Studio in Singapore (May 12, 2005), *available at* http://app-stg.mti.gov.sg/default.asp?id=148&articleID=1262.

[15] *See, e.g.*, Economy Watch, Singapore Economy, http://www.economywatch.com/world_economy/singapore/ (last visited Aug. 13, 2009).

[16] For details of the USTR-Singapore Free Trade Agreement, see Office of U. S. Trade Rep., Singapore FTA, *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Section_Index.html.

[17] For details of the Singapore-Australia Free Trade Agreement, see https://www.fta .gov.au/default.aspx?FolderID=271 & Article ID=217. These are Regional Free Trade Agreements within the World Trade Organization rules and have been notified to the World Trade Organization.

[18] GAVIN PEEBLES & PETER WILSON, ECONOMIC GROWTH AND DEVELOPMENT IN SINGAPORE: PAST AND FUTURE 263 (2002).

[19] For example, in 2008 the World Economic Forum ranked Singapore the fifth most competitive economy in the world. *See* World Economic Forum, Global Competitiveness Report 2008–2009, at 12, http://www.weforum.org

direct investment was part of an economic plan developed in the 1960s. In 1961, the Economic Development Board was established to formulate and implement economic development strategies to create a manufacturing base. Industrial estates were established and tax incentives were granted to attract foreign direct investment.[20] The British naval base, with the largest dry dock in the region, was transferred gratis to the Singapore government in 1971 and the sea port rapidly became a major container cargo terminal and ship repair base. Shell and Exxon were attracted to build regional oil refineries in Singapore, and by the mid-1970s Singapore had become the third largest oil refining center in the world.[21] Government promoted the development of Singapore Airlines and built a major airport at Changi, which has become a major regional aviation hub as well as a principal stop-over on the "Kangaroo" route between Europe and Australia.[22] Singapore has also become a major silicon chip manufacturing center[23] and the government has also heavily promoted the financial services industry and the trade-related services sector.[24] However, while export-oriented, capital-intensive investment has been welcomed, most domestic nontraded sectors have traditionally been protected, and many of them have become controlled directly or indirectly by state-owned corporations or through companies linked to the state.

2. GOVERNMENT-LINKED COMPANIES While making Singapore an investment-friendly destination for foreign direct investment

/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm. *See also* Heritage Foundation, 2009 Index of Economic Freedom, http://www.heritage.org/Index/topten.cfm (ranking Singapore second in economic freedom in 2009).

20 *See* Peebles & Wilson, *supra* note 18, ch. 7.

21 *See, e.g.*, Singapore: A Country Study (Barbara Leitch Lepoer ed., 1989), *available at* http://countrystudies.us/singapore/35.htm. *See also* Lee, *supra* note 7, at 68.

22 *See* W. G. Huff, The Economic Growth of Singapore (1994). *See also* Lee, *supra* note 7, at 202–04.

23 Peebles & Wilson, *supra* note 18, at 97–101.

24 An example of the government's active involvement in promoting Singapore goods and services is the International Enterprise Singapore. *See* http://www.iesingapore.gov.sg/wps/portal (last visited Aug. 13, 2009).

involved in exported products and services, the majority of the domestic economy has been reserved for Singapore companies connected with the state. The utilities sector—gas, electricity, telecommunications, and public transport—were all originally state monopolies, though since the 1990s partial privatization has been undertaken in several of these sectors, and limited competition has been promoted.[25] However, the government still retains indirect ownership or decisive influence in many parts of the domestic economy through government-linked companies (GLCs).

GLCs are wholly or partly government-owned companies that are held by two principal state holding companies—the Government of Singapore Investment Co. (GIC) and Temasek Holdings Pte. Ltd. (Temasek). These two unlisted companies are wholly owned by the Singapore government. GIC was established in 1981 to manage Singapore's foreign currency reserves. Recently, *The Economist* reported that Morgan Stanley had estimated that GIC controlled an investment fund of US$300 billion.[26] However, GIC admits only that its investment portfolio is "well above US$100 billion."[27] GIC tends to invest overseas through portfolio investment in the stock of quoted companies, private equity houses, bonds and real estate, as well as in foreign exchange and commodities. The Chairman of the board of GIC is the former Singaporean Prime Minister, Lee Kuan Yew.[28]

Temasek was established in 1974 to act as the holding company for government-owned stakes in various commercial enterprises and to be the holding company of a number of large-scale businesses wholly owned by the state. These businesses operate both inside Singapore and in foreign countries. Temasek controls a fund of approximately US$160 billion, as estimated by Morgan Stanley. Temasek's CEO was Ho Ching, wife of the current Prime Minister Lee Hsien Loong and daughter-in-

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25 PEEBLES & WILSON, *supra* note 18, ch. 2.

26 *Asset Backed Insecurity*, THE ECONOMIST, Jan. 17, 2008, at 78–80.

27 *See* Government of Singapore Investment Corp., http://www.GIC.com.sg/aboutus.htm (last visited Aug. 13, 2009).

28 Government of Singapore Investment Corp., http://www.gic.com.sg/aboutus_mgtteam.htm.

law of Lee Kuan Yew until she announced retirement in February 2009.[29] Temasek is an active shareholder and investor in a wide variety of sectors including banking and financial services, real estate, transport and logistics, infrastructure, telecommunications, television and newspapers, bioscience and healthcare, education, consumer products, engineering, and high technology, as well as energy resources. While investments are held both domestically and overseas, approximately seventy-five percent of Temasek's holdings are Singapore based.[30]

As regards the Singapore domestic economy, Temasek owns 100% of Media Corp and Singapore Press Holdings, the two media companies that collectively completely control terrestrial television broadcasting and the local print media, newspapers and magazines. In telecommunications, Temasek holds 55% of Singapore Telecommunications, the former wholly state-owned monopoly, and 100% of Singapore Technologies Telemedia; these companies dominate the telecommunications and Internet markets in Singapore. In the transport sector, Temasek holds 100% of PSA International, the owner of Singapore's container port, which is the largest in the world by volume; 66% of Neptune Orient Lines, a major shipping company; and 54% each of Singapore Airlines, the dominant air carrier, and SMRT, the railway monopoly. In the real estate sector, Temasek owns 100% of Maple Tree Investments and 40% of CapitaLand, two of the major domestic real estate development companies. In infrastructure and engineering, Temasek has control or owns a substantial share of Singapore Technologies Engineering, SembCorp Industries and Keppel Corporation. In energy and resources, it is the sole owner of PowerSeraya, Senoko Power and Singapore Power, the latter being the major electricity supplier in Singapore. In the technology sector, Temasek has substantial stakes in Chartered Semiconductor Manufacturing and

[29] The effective date of her retirement is October 1, 2009. *See* Bei Hu & Yoolim Lee, *Temasek CEO Ho Ching to Leave; Goodyear to Take Over (Update2)*, BLOOMBERG.COM, Feb. 6, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601081&refer=australia&sid=anBvGhDTLqn8 (last visited Aug. 13, 2009).

[30] *See* Temasek Holdings, Major Investments, *available at* http://www.temasekholdings.com.sg/our_portfolio_portfolio_highlights_major_investments.htm (last visited Aug. 13, 2009).

STATS ChipPAC. Temasek also has interests in food processing, leisure and entertainment services. Finally, in financial services, Temasek has a substantial stake of 28% in DBS Holdings Group, one of Singapore's major banks.[31]

The range and extent of these holdings have been controversial both within Singapore and overseas. The government has maintained that its interest in GLCs amounts to a relatively small percentage of the overall domestic economy (thirteen to twenty percent of gross domestic product), whereas outside observers including the U.S. embassy in Singapore, have considered that GLCs control up to sixty percent of the domestic economy.[32] This controversy clearly has significant implications in relation to competition conditions within the domestic economy and indeed was one of the reasons why the United States, in the free trade agreement negotiations, insisted that Singapore agree to adopt a general competition law within two years of the coming into force of the agreement.[33] Issues concerning market access as well as a perception that the playing field is tilted in favor of GLCs are matters that have concerned both domestic and overseas competitors as regards the domestic Singapore market.[34] Allegations that GLCs receive preferential access to finance or preferential treatment in relation to government procurement contracts have been hotly disputed by the Singapore authorities.[35]

An International Monetary Fund (IMF) working paper appeared to support the government's position that GLCs were not given pref-

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[31] *Id.*

[32] Saeed Azhar, *Economy: Singapore Urged To Loosen Econ Grip*, DOW JONES NEWSWIRES, Mar. 3, 2006.

[33] All U.S. regional trade agreements have required the adoption of an antitrust regime where the other country does not already have a competition law in place. *See, e.g.*, Office of U.S. Trade Rep., *supra* note 16.

[34] *See, e.g.*, U.S. Dep't of Commerce, Singapore, *available at* http://singapore.usembassy.gov/uploads/images/uWEK7j2J2BM0mCVrI2DqRg/NTE_2008_Singapore.pdf (raising government procurement issues).

[35] *See, e.g.*, *Singapore Inc. II*, BUS. TIMES SING., Sept, 3, 2002. where it was stated that the (then) Deputy Prime Minister Lee Hsien-Loong focused his speech on "robust rebuttal of . . . many familiar criticisms GLC's" in the parliamentary debate.

erential access to funding or procurement contracts, though it did identify an unusual anomaly, namely that GLCs appeared to have a twenty percent enhancement of their stock market value over and above what would be considered fair value for a similar non-GLC company. The authors concluded that this premium resulted from an enhancement of their reputation and a perception of greater solidity, rather than as a result of more favorable government treatment. This conclusion was reached after taking into account the fact that GLCs tended to be much larger than private sector competitors and so were potentially able to reap the benefits of economies of scale or the exercise of market power.[36] In 2001, the performance of GLCs was criticized by Morgan Stanley, which opined that investment returns during the 1990s had been poor.[37] However, an academic study that considered the issue of whether GLCs underperform comparable businesses and so waste public resources by being less efficient, concluded that GLCs were as efficient in their use of capital and provided investment returns similar to those of non-GLCs in similar lines of business.[38] Thus, the evidence appears to suggest that GLCs are not given preferential treatment and also operate on a commercial basis.

3. GOVERNMENT-LINKED COMPANIES AND THE DEVELOPMENT OF COMPETITION POLICY The issue of GLCs and competition in the Singapore domestic market was raised in a subcommittee report of the government-appointed Economic Review Committee on Government in Business. The Committee argued strongly in favor of a general competition law that should apply to GLCs to provide a level playing field between GLCs and the private sector.[39] A

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[36] Carlos D. Ramirez & Ling Hui Tan, *Singapore, Inc. Versus the Private Sector: Are Government-Linked Companies Different?* (IMF Working Paper WP/03/156, July 2003).

[37] Sara Webb, *Government-linked Firms Spark Debate*, Wall St. J., Asia, Dec. 26. 2001 (quoting Daniel Lian, Morgan Stanley Dean Witter).

[38] Fang Feng, Qian Sun & Wilson H.S. Tong, *Do Government-linked Companies Underperform?*, 28 J. Banking & Fin. 2461 (2004).

[39] Entrepreneurship and Internationalisation Subcommittee, Economic Review Committee, Recommendations on Government in Business (May 30, 2002), *available at* http://app.mti.gov.sg/data/pages/507/doc/ERC_EISC_MainReport.pdf .

subsequent Parliamentary debate on a proposed Charter of Government-linked Companies in 2002 echoed these sentiments.[40]

In that Parliamentary debate, the ability to compete in the Singapore domestic market was thought to be clearly influenced by the existence and operation of GLCs. They had been accused of "crowding out" the private sector and inhibiting innovation and entrepreneurship. Diversity of ownership of economic assets, spreading risk, and encouraging private business, it was argued, would also strengthen the resilience of the domestic economy to better withstand future external economic shocks and ensure continued prosperity. The government apparently took note of these views.

First, government made a decision to enact a general competition law that would provide a legislative framework within which competition would take place. This law would, to some extent at least, counterbalance the real or perceived competitive advantages GLCs might possess because of their status rather than as a result of their inherent performance. However, other reasons have also been suggested as motivating the government's decision to legislate.

The partial privatization of several former state-owned monopolies and wholly owned enterprises had included the introduction of sectoral competition rules in the utility and telecommunications sectors,[41] which at least potentially subjected these sectors to unequal treatment as other sectors of the economy were not subject to antitrust rules. This could conceivably have led to a misallocation of capital based on regulatory inequality rather than on business logic. The enactment of a general law would rectify this anomaly.

Second, the government wanted to toughen up pampered or cosseted domestic firms to make them fit for global competition, especially in light of the 2001–2002 recession.[42] Additional competition

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40 Singapore Parliamentary Debates, vol. 75, col. 805 (Aug. 27, 2002).

41 *See, e.g.*, Infocommunications Development Authority, Code of Practice for Competition in the Provision of Telecommunication Services 2005, *available at* http://www.ida.gov.sg/Policies%20and%20Regulation/20060602164621.aspx.

42 *Singapore admits worst ever recession*, BBC NEWS, Feb. 28, 2008, *available at* news.bbc.co.uk/1/hi/business/1845914.stm.

might provide a spur to improvement. Third, a competition law would reassure potential foreign investors that they would receive equal legal protection from anticompetitive practices, thus encouraging additional foreign investment. Last but not least, the mandatory provisions of the 2003 U.S.-Singapore Free Trade Agreement and the Australian agreement required the enactment of a competition law.[43]

Reducing the role of GLCs was a topic of debate in the last general election campaign in 2006. The Prime Minister stated that Temasek would rebalance its portfolio so that ultimately its exposure to the domestic economy would be reduced from one-half to about one-third.[44] It is too soon to tell whether this policy has been put into effect. No timetable for this change was announced at the time of the election or subsequently, and foreign analysts consider that such a divestment from the domestic economy would be difficult for the government to achieve both for economic and political reasons. Professor Gary Rodan, Director of the Asia Research Centre of Murdoch University, Australia, has opined that "[w]hat is at stake here is not just control of economic assets, but also the related capacity this control affords the government for domestic, social and political influence. . . . [T]his capacity won't be surrendered lightly."[45]

As regards overseas activities, some of Temasek's investments have been controversial. In recent years, the activities of sovereign wealth funds and state-directed investment in foreign countries have become increasingly politicized. The United States, the European Union, the OECD and the IMF have all been engaged in attempts to persuade sovereign wealth funds to enter into a code of conduct to enhance transparency and accountability.[46] However, these funds have

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43 *See supra* notes 16 & 17 and accompanying text.

44 *See* Singapore Ministry of Finance, Budget Debate Roundup Speech 2006 (Mar. 10, 2006), *available at* http://www.mof.gov.sg/budget_2006/roundup_speech/subsection3.3.html. *See also* Sara Webb, *Singapore Inc.'s Loads War Chest for Future Forays*, NEW ZEALAND HERALD, Mar. 25, 2006, *available at* http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10374316.

45 Quoted in Azhar, *supra* note 32.

46 *Wealth Funds Strike Deal with Washington*, FINANCIAL TIMES, Mar. 22, 2008.

played a prominent role in the recent recapitalization of a number of Wall Street and European investment banks as a result of the disastrous losses that have flowed from the subprime mortgage crisis, and so political pressure on them may well subside.[47] Domestically, Temasek's investments in foreign banks have created some public discontent due to the huge falls in stock prices over the last year. Temasek's chief executive resigned in February 2009 and will replaced in October 2009.[48]

At the regional level, some of Temasek's investments in the telecommunications sector in South East Asia have been problematic. The purchase of a controlling interest in Shin Corp., the dominant mobile telecommunications company in Thailand, from the family of the former Prime Minister, Thaksin Shiniwatra, was said to be one of the factors that led to the ouster of the Thaksin government by a military coup in September 2006. The purchase led to subsequent diplomatic difficulties between Singapore and Thailand.[49] In neighboring Indonesia, Temasek's interests in the two dominant mobile telephone companies, Indosat and Telkomsel, although approved by the regulatory authorities and purchased from the Indonesian government in 2002, have now fallen afoul of an antitrust investigation by the Indonesian Competition Commission (KPPU). Temasek vehemently denied that the KPPU had jurisdiction to undertake its investigation because Temasek did not have control of either of the two companies. Temasek also rejected the assertion that it instigated any anticompetitive conduct by the two operators or indeed that there was any unlawful conduct at all.[50] On appeal to the Supreme Court of Indonesia, the KPPU decision

[47] *Merrill Gets Cash Injection from Temasek*, Financial Times, Dec. 24, 2007. Also, GSIC injected a large tranche of capital to help support UBS's balance sheet in the light of huge losses as a result of the subprime mortgage debacle in December 2007. *See UBS Capital-raising Boosts Financial Sector*, Financial Times, Dec. 11, 2007.

[48] *See supra* note 29 and accompanying text.

[49] *Ministry to Investigate Temasek Purchase of Shin Corp.*, Financial Times, Oct. 3, 2006.

[50] *Temasek Falls Foul of Competition Regulations*, Financial Times, Nov. 19, 2007).

was upheld[51] and Temasek subsequently sold its shares to Qatar Telecom.[52]

D. Temasek, the GLCs, and competition issues in the domestic market

The presence of GLCs in many sectors of the domestic economy, their size, scale, and resources necessarily raises the issue of whether many markets are contestable. The Singapore domestic market is small and unsurprisingly subject to high concentration ratios especially in capital intensive sectors. Temasek is a conglomerate with apparently significant market power and has access to a deep pool of publicly administered funds. These circumstances are somewhat unusual in a market-oriented economy. However, arriving at conclusions as to the extent and nature of Temasek's market power is difficult without undertaking a comprehensive competition assessment with access to accurate market data.

It can be argued that high entry barriers may exist, oligopolistic behavior may be facilitated, and anticompetitive conduct is obviously possible in a market with these characteristics. The scale and extent of GLC operations has proven to be very difficult to establish, and this fact has been seen as a major concern in determining whether the new competition law will be able to open markets and ensure contestability.[53]

Another problematic matter is the precise relationship of the new competition agency with its sponsoring department, the Ministry of Trade and Industry (MTI). The MTI is also responsible for a number of statutory boards, some of whose officers are also directors of GLCs. The perception that a conflict of interest might arise as a result of this institutional architecture was raised in Parliament during passage of

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[51] *UPDATE 1-Indonesia Rejects Temasek Anti-trust Appeal*, Reuters, Sept. 12, 2008, *available at* http://www.reuters.com/article/rbssIntegratedTelecommunicationsServices/idUSJAK34958520080912.

[52] *See* Dahana Rekan, Indonesian Law Update 2008 (June 2008), http://www.dahanarekan.com/DR_LawUp4.htm.

[53] *See* Rodney King, The Singapore Miracle, Myth and Reality (2d ed. 2008).

the Competition Bill[54] and remains a live issue when assessing the effectiveness of procompetition policy.

III. HISTORY, POLITICS AND ECONOMIC STRUCTURE OF HONG KONG

A. History

Hong Kong has a territory of 426 square miles (about 30% larger than the land area of New York City)[55] and consists of two large islands, many other small islands, the Kowloon peninsula, and the New Territories. Hong Kong is situated on the south coast of China adjacent to the Pearl River Delta. The topography is very hilly with many steep-sided mountains, several over 3,000 feet. Consequently, flat land is scarce and commands a very high premium. Contributing to the scarcity of development land is the fact that only sixty percent of the territory is developed and forty percent is preserved as country park land. This policy greatly enhances Hong Kong's environment but also has economic consequences in exacerbating land scarcity. The population is approximately seven million, of which ninety-five percent are ethnically Chinese, two percent are Filipino, and the remaining three percent consist of other racial groups.

Hong Kong attracted British attention in the 1840s as the ideal secure base from which to conduct trade in desirable Chinese products—tea, silk, and porcelain. Traditionally, China maintained a very restrictive trade policy with foreign merchants and all trading activity was confined to an island in the Pearl River at the city of Canton. China would sell its products only for silver bullion through nominated Chinese merchants and would not buy foreign goods in exchange. This caused a huge drain on bullion reserves especially for the British monopoly trader, the East India Company. However, over time, a disreputable and illicit trade in Indian-produced opium developed. British private merchants were at the forefront of this trade, especially after the East India Company's trading monopoly was rescinded in 1833. Chinese attempts to suppress opium importation

[54] Inderjit Singh, Member of Parliament, Second Reading Debate, Singapore Parliamentary Debates, vol. 78 at col. 863 (Oct. 19, 2004).

[55] New York City Dep't of City Planning, *supra* note 3.

created the trade and then political friction that resulted in the outbreak of the First Opium War, ostensibly with Britain seeking to uphold the principle of free trade by attempting to force open Chinese markets to foreign goods.[56]

Hong Kong island was seized by British forces in 1841 as a base of military operations and was subsequently ceded in perpetuity by the Chinese Empire pursuant to the Treaty of Nanking signed on August 29, 1842, to mark the end of the First Opium War.[57] The original seizure of Hong Kong island was supplemented by the addition of the Kowloon peninsula in 1861 as a result of settlement of the Second Opium War.[58] In 1896, the New Territories were leased to Britain for ninety-nine years,[59] and as they formed over eighty percent of the geographical area of the colony, the reversion of this tract of land to mainland sovereignty was an ever present reminder of the potential impermanence of the colony. The fact that most of Hong Kong was not "freehold" led to many economic and political consequences. In particular, all land grants were leaseholds valid up to the date of reversion of most of the territory to China in 1997. Potential political reforms after 1945 were also subject to this constraint in that Britain concluded that decolonization and independence for Hong Kong was not an option given China's refusal to countenance any partition of the motherland.[60]

After colonization, Hong Kong became an entrepôt trading center dealing in Western imported manufactured goods for the China market and exporting Chinese products to the West. Hong Kong was generally regarded as something of a backwater when compared with Shanghai to the north and Singapore to the south, but its port provided the economic

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56 *See* FRANK WELSH, A HISTORY OF HONG KONG, 32–61 (1997).

57 *Id.* at 120–31. *See also* MARK WILLIAMS, COMPETITION POLICY AND LAW IN CHINA, HONG KONG AND TAIWAN 97–100 (2005).

58 The ceding of Kowloon was the result of the Convention of Peking signed on October 18, 1860. *See* WELSH, *supra* note 56, at 209.

59 The lease was executed pursuant to the Convention of Peking signed on June 9, 1898.

60 *See* ROGER NISSIM, LAND ADMINISTRATION AND PRACTICE IN HONG KONG 9–35 (2007), which provides a historical description of land development in Hong Kong and the political and economic effects of land administration.

lifeblood of the territory. Hong Kong's population became composed of mainly of Chinese nationals who migrated to the colony as a result of the chronic political and economic instability during much of the colonial period. Waves of migrants sought greater economic and political stability in the British enclave. The overthrow of the Qing empire, internecine civil warfare, and the Japanese invasion of China in the 1930s all increased the influx of refugees. The outbreak of war between Japan and Great Britain in late 1941 led to the invasion and occupation of the colony until 1945. Post-war Hong Kong was again subject to repeated waves of migration caused by the continuation of civil war in China, the seizure of power by the communists in 1949, and the various economic and political crises in China from the 1950s to the 1970s.

After World War II, Hong Kong colonial administrations were very weary of introducing political modernization, even though other colonies in the Caribbean, Africa, and Asia were readied for independence by the introduction of representative government. Hong Kong was seen as different. The limited duration of British sovereignty over most of the colony, the Chinese origin of ninety-five percent of the population, the fact that Hong Kong was very dependent on the mainland for most of its food and water, Cold War tension, and the ever-present implicit threat of invasion, all deterred the British authorities from embracing political change.[61]

China allowed the status quo to continue as Hong Kong was a useful window to the world during its isolationist phase between the early 1950s and the late 1970s, as well as the only conduit for such limited foreign trade and international financial operations as it chose to carry out.[62]

Consequently, political development was hindered, with senior officials appointed by London occupying the chief political and administrative offices and a nominated legislative assembly providing a formal but limited channel for local participation in the government. This logjam was cleared in 1984 when the British and Chinese governments signed a Joint Declaration agreeing that the whole of Hong Kong would revert to

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[61] *See* WELSH, *supra* note 56, and STEVE TSANG, A MODERN HISTORY OF HONG KONG 16–28 (2004).

[62] *See* TSANG, *supra* note 61, at 162.

Chinese sovereignty in 1997.[63] The Joint Declaration included a promise of a high degree of autonomy and guaranteed civil, political, and economic rights for at least fifty years from the handover.[64] Despite these promises, Hong Kong suffered a significant flight of middle class residents between the 1989 Tiananmen Square crackdown by the Chinese authorities and the handover of sovereignty on July 1, 1997.[65]

B. Current political structure and institutions

Hong Kong became a special administrative region of the People's Republic of China on July 1, 1997, and is governed by the Basic Law, a mini-constitution that preserved the pre-existing capitalist economic system and also guaranteed a high degree of political and economic autonomy for the territory.[66] The common law system has been preserved, so ensuring legal continuity.[67] The courts have remained independent and impartial with the government often losing constitutional, commercial, and criminal cases.[68]

Hong Kong's executive arm of government is comprised of a Chief Executive, a cabinet—the Executive Council—and the various departments of government headed by a minister appointed by the Chief Executive and staffed by civil servants.[69] The Chief Executive is selected by a largely undemocratic elected committee of 800 which has an in-

[63] The Joint Declaration between Britain and China was signed on December 19, 1984.

[64] For details, see Hong Kong Special Administrative Region, Basic Law, *available at* http://www.basiclaw.gov.hk/en/index/.

[65] *See* WILLIAMS, *supra* note 57, at 229.

[66] *See* Hong Kong Special Administrative Region, Basic Law, *available at* http://www.basiclaw.gov.hk/en/facts/index.html.

[67] Basic Law, art. 8.

[68] *See, e.g.*, Ng Ka Ling v. Director of Immigration, 2 HKCFAR 4 (1999), where the government lost in the Court of Appeal. However, the decision was subsequently reversed by the National People's Congress Standing Committee in Beijing. Fortunately, the reversal was an isolated incident.

[69] For the organizational structure of the Hong Kong government, see GOVHK, Government Agencies, Government Structure, http://www.gov.hk/en/about/govdirectory/govstructure.htm.

built majority to favor the official candidate.[70] Ministers are not elected directly nor do they have to be members of the legislature, as in a parliamentary system. The legislature is only partially chosen using democratic methods. Of the sixty seats in the Legislative Council, only thirty are directly elected on a one person, one vote franchise.[71] The other thirty members are representatives of commercial and sectional interests. These members are selected or elected by various industrial and professional groups. In some cases, companies have the vote and multiple voting by the same owner is permissible.[72] Any legislation must be approved by both groups of legislators separately, thus giving functional members a veto power in relation to any measure deemed to be unfriendly to business.[73] Needless to say, these political arrangements are designed to ensure that business interests are protected.

The commercial sector generally makes common cause with the Hong Kong government. The central authorities in Beijing have indirect influence over policy.[74] The "one country, two systems" formula discourages official criticism of mainland policies by the Hong Kong authorities but as a quid pro quo the central government generally refrains from direct public interference with local legal and commercial affairs. However, both formal and informal ultimate authority remains firmly in Beijing's hands.[75] A move to adopt more democratic institu-

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[70] *Id.*

[71] For details, see Legislative Council (Hong Kong), Legislative Council Today, http://www.legco.gov.hk/english/index.htm (last visited Aug. 13, 2009).

[72] *Id.* at Procedures, Rules of Procedure, part J.

[73] *Id.*

[74] *See* WILLIAMS, *supra* note 57.

[75] The Hong Kong Basic Law provides that Hong Kong retain a high degree of autonomy (article 12) but the central government is responsible for defense and foreign affairs (articles 13 and 14), and appoints the senior executive officers of the Hong Kong government (article 15). Beijing retains the right to invalidate local laws not in conformity with the Basic Law (article 17), and the ultimate authority to interpret the Basic Law resides with the Standing Committee of the National Peoples Congress—a political body—and not with Hong Kong's Court of Final Appeal or with China's Supreme People's Court (article 158). *See* Basic Law, http://www.info.gov.hk/basic_law/fulltext/.

tions is envisaged in the Basic Law, but it may well take at least another decade to come to fruition. Ultimately Beijing is able to dictate the speed of progress and the political model that will finally be adopted.[76]

Despite the undemocratic nature of Hong Kong institutions, civil and political liberty is well protected, and these rights are exercised fully by citizens who have few restrictions on freedom of speech and freedom of assembly and association.[77]

The Hong Kong Government is generally seen to be administratively efficient and corruption rates are low.[78] Hong Kong also regularly appears at the top of business friendly locations and wins accolades in various international league tables.[79]

C. *Migration and economic development*

The majority of Hong Kong's population has migrated from the neighboring Guangdong province. The civil war between the nationalists and the communists ultimately led to the communist seizure of power in mainland China in 1949, causing a flood of refugee emigration into Hong Kong from south China. The new immigrants included

[76] In 2004, the Central Government refused to allow movement toward a more democratic method of electing the Hong Kong Chief Executive or the whole Legislative Council. *See Top Legislature Interprets Basic Law*, Xinhua, *available at* http://news.xinhuanet.com/english/2004-04/06/content_1404321.htm.

[77] In 2009, Freedom House ranked Hong Kong as "partly free" as a result of these limitations on political liberty. *See* Freedom House, Country Report, http://www.freedomhouse.org/template.cfm?page=22&year=2009&country=7741.

[78] Transparency International ranked Hong Kong as the 12th least corrupt jurisdiction out of 180 countries and territories surveyed. *See* Transparency International, 2008 Corruption Perceptions Index, *available at* http://www.transparency.org/content/download/23972/358236.

[79] For example, in 2008 the World Economic Forum ranked Hong Kong the 11th most competitive economy in the world. *See* World Economic Forum, Global Competitiveness Report 2008–2009, at 12, http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm. *See also* Heritage Foundation, 2009 Index of Economic Freedom, http://www.heritage.org/Index/topten.cfm (ranking Hong Kong the "world's freest economy" in 2009).

a large number of wealthy entrepreneurs, primarily from Shanghai—bankers, ship owners, and manufacturers—who brought capital, know-how, and equipment with them. This was the beginning of the economic transformation of post-war Hong Kong with the establishment of light manufacturing and the build-up of the logistics industry.[80]

The colony had been established to mimic Singapore's prior success by being designated a free port. Historically, government sources of revenue were very limited and so the sale of land on leasehold terms was the primary source of income.[81] This practice continues to this day, and land revenues provide upwards of thirty percent of recurring government income.[82] Government never became directly involved in trade or business and acted as a mere facilitator of commerce. The colonial government adhered to a low taxation policy with minimal intervention in the economy while providing basic public services—security, limited educational services and public health. This basic "small government" stance has been maintained throughout Hong Kong's existence, even in the decade after retrocession to China.

However, as the colony's population exploded in the 1950s and 1960s, the noninterventionist colonial administration, while maintaining a dogged belief in a laissez faire economic policy, began massive public housing and infrastructure projects to cope with the much larger population.[83] Whole new towns had to be planned and built and eventually fifty percent of the population was housed in government apartments; this situation has remained unchanged.[84] However, pri-

80 LEO F. GOODSTADT, PROFITS, POLITICS AND PANICS: HONG KONG'S BANKS AND THE MAKING OF A MIRACLE ECONOMY, 1935–1985 (2007).

81 NISSIM, *supra* note 60, at 3–17.

82 *See* Paul Lau, *Examining the Hong Kong Government Budget and Fiscal Reserves from a Macroeconomic Perspective (2001)*, *available at* http://www.hktdc.com/econforum/hkcer/hkcer010103.htm. This paper illustrates the dependence of the Hong Kong government on revenue from land sales. This position has not materially changed since the paper was written.

83 NISSIM, *supra* note 60, at 48.

84 *See* Hong Kong Housing Authority, Housing Statistics, Housing in Figures 2008, *available at* http://www.housingauthority.gov.hk/en/aboutus/resources/figure/0,,2-0-0-2008,00.html.

vate real estate development provided the bedrock of domestic economic activity and underpinned both the stock market and the financial sector. Banks granted loans secured by mortgages of real estate to both private businesses and to residential buyers on the basis that limited land supply and growing demand would lead to ever-inflating property prices.[85] Manufacturing textiles, clothing, radios, small electronic and electrical devices, plastic molded products, toys and watches also became major economic activities. None of these industries was fostered by government or subsidized with public finance. Hong Kong relied on the private sector, not public-directed investment, in marked contrast to the post-independence Singapore model.

In the late 1970s, China adopted its "open door" policy, and Hong Kong businesses were the first to take advantage of the new commercial opportunities across the border.[86] Cheap land and labor beckoned with a virtual absence of regulatory restraints on employment conditions or environmental protection. By the mid-1980s, the trickle of investors from Hong Kong had become a flood, and Hong Kong's role as a manufacturing center was over. Instead Hong Kong's domestic economy rapidly evolved into a service center providing back office and support functions to underpin the explosive manufacturing sector growth across the border in the Pearl River Delta region. Additionally, professional services in law, accountancy, engineering, design, logistics, merchandizing and, most importantly, finance also flourished as an adjunct to the three-decade long economic boom that has characterized China's rise from economic obscurity to major world power.[87] Hong Kong's role in that transformation has been pivotal. The comparative advantage of Hong Kong's entrepreneurs using China as a manufacturing hub has come from linguistic, cultural, and ethnic affinity as well as geographical proximity. The ability to communicate with and act as a conduit for foreign participation in China's economic transformation has also proved highly profitable for Hong Kong. Most of Hong Kong manufacturing businesses are now based in mainland China but headquartered in Hong Kong.

[85] Goodstadt, *supra* note 80.

[86] Nissim, *supra* note 60, at 47.

[87] *Id. See also* Williams, *supra* note 57.

They have to compete in international markets and are very competitive. However, many large scale enterprises rooted in the domestic Hong Kong market are different, as will be explained below.

Hong Kong has no administrative restrictions on foreign investment, a low taxation regime, anda business-friendly environment with a "small government" philosophy.[88] Hong Kong has low corruption rates and a highly efficient business services sector facilitated by excellent physical infrastructure in telecommunications, a major international air transport hub, and one of the largest and most efficient container ports in the world. There are few restraints on entrepreneurial activity, and Hong Kong continues to benefit from this business-friendly environment and vies annually with Singapore for the various accolades acknowledging "economic" or business freedom. However, while Hong Kong has many competitive advantages as a business base, many parts of the domestic economy are monopolized and subject to anticompetitive distortions.

D. Structure of the domestic economy

While the externally traded sector is privately owned, diverse, and internationally competitive, many sectors of the domestic economy are very concentrated and dominated by a small number of family-controlled diversified conglomerates.[89] This is especially so in sectors that are capital intensive, where market players need to be of substantial size and scale. High concentration ratios are not surprising in a small economy. Defining what constitutes a "small" economy is problematic, but Hong Kong must come within any reasonable definition of smallness.[90] The disadvantages of smallness are often intensified by isolation, and one must remember that despite Hong Kong's

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[88] *See* Press Release, Hong Kong Special Administrative Region, Big Market, Small Government (Sept. 18, 2006), *available at* http://www.ceo.gov.hk/eng/press/oped.htm.

[89] *See* GOODSTADT, *supra* note 80. *See also* TONY LATTER, HANDS ON OR HANDS OFF? THE NATURE AND PROCESS OF ECONOMIC POLICY IN HONG KONG 133 (2007).

[90] *See* MICHAL S. GAL, COMPETITION POLICY IN SMALL MARKET ECONOMIES (2003).

physical proximity to mainland China, in many respects there was little economic integration with the mainland from the establishment of the colony in the 1840s until the 1980s. While traditionally Hong Kong was dependent on the mainland for food supplies and water, most purely domestic economic activities were isolated from integration within the south China region primarily for ideological and political reasons. Under the British, especially after 1949, Hong Kong's domestic economy developed quite separately from that of China.

The practice of capitalism continued in Hong Kong but was replaced by orthodox command-economy Marxism in China after the revolution.[91] The stationing of up to 40,000 British troops in the 1950s to act as a Cold War trip-wire, together with the hostility of the mainland authorities to the continued foreign occupation of the last colonized speck of Chinese territory, ensured that the movement of people, capital, and most products was very limited. The border was rigidly policed on both sides and effectively isolated the domestic Hong Kong economy from its natural hinterland. This began to change slowly only in the 1980s when China's policy to open up took effect, but even today, a decade after reunification, much of the domestic Hong Kong economy is still quite separate and distinct from its nearest neighboring city, Shenzhen. In fact in many respects, the still existing border is a greater barrier between Hong Kong and the rest of China than are the international frontiers that still remain within the more economically integrated European Union. This unusual arrangement within a single sovereign state is exemplified by the fact that Hong Kong retains its own distinct legal and political institutions, its own currency, financial reserves, a separate customs territory, and even a separate membership in international organizations such as the World Trade Organization.[92]

As a result of this relative isolation, Hong Kong developed its own self-contained electricity and piped gas supplies, its own super-

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[91] *See* WELSH, *supra* note 56, and WILLIAMS, *supra* note 57.

[92] Hong Kong became a member of the WTO on January 1, 2005. World Trade Org., Member Information, http://www.wto.org/english/theWTO_e/countries_e/hong_kong_china_e.htm, whereas China became a member on December 11, 2001. World Trade Org., Member Information, http://www.wto.org/english/thewto_e/countries_e/china_e.htm.

market and retail chains, its own petroleum distribution network, and its own transport infrastructure in the form of a major international airport, a huge container port, and public transport services. Hong Kong has its own shipping lines, flag-carrying airlines, real estate developers, professional service providers, banks, insurance companies, and brokerages; all these businesses developed in post-war Hong Kong quite divorced from any significant integration with the south China region. Even though Hong Kong was a relatively small and potentially a risky place to do business, the unpredictability of mainland China forced local family firms with entrepreneurial skill and ambition to grow their businesses domestically, usually from a real estate development base. This was the most profitable business in Hong Kong given the government monopoly of the supply of development sites. A policy of drip feeding the market to ensure scarcity so as to maintain high prices to enhance government revenues, in lieu of realistic rates of direct or indirect taxation to fund public services, secured the Faustian pact between the colonial administrators and the local elite in post-war Hong Kong.[93] The colonial Hong Kong government habitually ensured a budget surplus by use of this strategy and by refusing to provide anything but the most basic public services. In this way, Hong Kong accumulated huge fiscal surpluses.[94] Hong Kong to this day still has no comprehensive social security system or publicly funded old age pension scheme. Publicly funded compulsory six-year secondary education became mandatory only in the 1980s.[95] The refusal to expand social spending kept public expenditure under strict control, and the government aims to ensure that public spending not constitute more than twenty percent of gross domestic product on average.[96] As a result, when the colony reverted to China, a huge financial dowry accompanied the handover; these funds are still

[93] This symbiotic relationship is well described and analyzed in GOODSTADT, *supra* note 80.

[94] *See* TONY LATTER, HONG KONG'S MONEY: THE HISTORY, LOGIC AND OPERATION OF THE CURRENCY PEG (2007).

[95] *See* Hong Kong 2004, History, The Post-War Years, http://www.yearbook.gov.hk/2004/en/21_07.htm.

[96] The Basic Law provides a constitutional mandate for fiscal prudence. *See* LATTER, *supra* note 89, at 50–51.

entirely locally controlled, however, as mandated by the Basic Law.[97] Thus while Hong Kong is part of China politically, it retains a marked degree of economic separation, though ever closer economic ties with the mainland will intensify integration in the long term.

1. MONOPOLY CONTROL OF LAND SUPPLY AND THE RISE OF THE CONGLOMERATES The symbiotic relationship between government and the real estate developers ensured that the sector became consolidated[98]; four major companies provide in excess of seventy-five percent of new residential accommodation,[99] and a slightly larger number control commercial property in the territory. Scarcity of provision and high resale prices also satisfied the banks that provided mortgages to residential buyers keen to participate in the ever-rising real estate market. An expanding population caused by high natural growth and large scale immigration, until at least the 1980s, ensured that the property market was a one-way bet. Despite the desire of the middle class to acquire real estate, Hong Kong has one of the highest GINI coefficients in the world and is very unequal in terms of income distribution.[100] A small percentage of the population is very wealthy, but the majority are on the borderline and about twenty-five percent of the population is officially recognized as below the official poverty line, which itself is set at a very low level.[101] This is another manifestation of Hong Kong's laissez faire economic policy.

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[97] *See* Hong Kong Special Administrative Region, Basic Law, art. 106 ("The Hong Kong Special Administrative Region shall have independent finances. The Hong Kong Special Administrative Region shall use its financial revenues exclusively for its own purposes, and they shall not be handed over to the Central People's Government.").

[98] *See* Goodstadt, *supra* note 80, at 93.

[99] *See* Hong Kong Consumer Council, How Competitive is the Private Residential Property Market? (1995), *available at* http://www.consumer.org.hk/website/wrap_en2/hse9607/hse_e.htm.

[100] *Don't Ignore the Danger Signs*, The Standard, May 12, 2005, *available at* http://www.thestandard.com.hk/stdn/std/Opinion/GE12Df01.html.

[101] Poverty increased from 14.8% to 17.7% between 1995 and 2005. Hong Kong Council on Social Services, Poverty in Hong Kong, *available at* http://www.hkcss.org.hk/cb4/ecp/pov_rate_91-05.pdf.

An unintended consequence of government's land policy has been the accumulation of vast wealth by a small group of major property developers. These family-dominated companies have rationally and successfully diversified their real estate profits into other sectors of the domestic economy that provide stable returns with strong cash flows. Many such acquisitions, untroubled by competition law scrutiny, have been in monopolized or oligopolistic industries that have high entry barriers. Formerly British-owned or controlled companies that benefited from privileged positions in the colonial era sometimes suffered from mismanagement or fell victim to recession. Often, these firms would then be acquired by local interests. One example of this process will suffice to explain this phenomenon and to illustrate the growth of the local conglomerates.

Li Ka Shing is Asia's second richest man.[102] From relatively humble beginnings in the 1940s, he has developed a huge international business empire that is still fundamentally underpinned by its Hong Kong base. Mr. Li became Asia's largest supplier of plastic flowers in the 1950s and expanded into property in the 1960s. His two flagship companies are Cheung Kong and Hutchison Whampoa, which are large diversified conglomerates with interests worldwide. In Hong Kong, Mr. Li's companies are major real estate developers with extensive interests in the residential, retail, and commercial sectors. In addition, these companies own approximately fifty percent of the Hong Kong container port, a ship repair company, the largest supermarket chain with about forty percent of total territory-wide grocery sales, the major electrical retailer, one of the two major drug store chains, one of the electricity monopolies,[103] and a very substantial telecommunications company. In addition, Mr. Li also has insurance

[102] Forbes Magazine estimated that Mr. Li was the 16th richest man in the world and the second richest in Asia with a fortune worth US$16.2 billion in 2009. *See The World's Billionaires,* FORBES.COM., http://www.forbes.com/2009/03/11/worlds-richest-people-billionaires-2009-billionaires_land.html.

[103] Hong Kong has two separate, privately owned electricity monopolies that are not interconnected. Each is subject to a privately agreed scheme of pricing control with the government that was renewed in January 2008. *See* Press Release, Secretary for the Environment, New Scheme of Control Agreements Reached with the Two Power Companies (Jan. 7, 2008), http://www.info.gov.hk/gia/general/200801/07/P200801070187.htm.

interests, several estate management companies, and controls a leading cement supplier, a chain of hotels, several Internet companies, and two radio stations.[104] Finally, Mr. Li's son also controls Hong Kong's dominant telecommunications operator, PCCW, the delisting and "privatization" of which has been blocked by an adverse court ruling.[105]

While Mr. Li's companies' prominence is exceptional, this pattern of diversified family-dominated conglomerates is widespread in the Hong Kong domestic economy. The lack of any antitrust rules concerning merger or monopolization has ensured that not only is ownership concentrated but many markets are now either monopolized, structured as oligopolies, or organized as cartels. This ownership pattern fosters significant barriers to entry in many markets as considerable intragroup commercial contracting is common, excluding new entrants in many fields of endeavor, and many of the sectors are uneconomic for new entrants. A hostile reaction by a powerful single-firm incumbent or by the existing oligopoly or cartel can often guarantee that new challengers are scarce. For example, gaining access to sufficient sites to operate a viable retail chain can be difficult or impossible.[106] Refusal to allow access to essential facilities and the use of naked market power have also been observed in various sectors over the years.[107]

Another unusual facet of the domestic economy is the absence of hostile merger activity. There has not been a hostile takeover of a Hong Kong-listed company in more than twenty years, as complex family cross-ownership structures and low free-stock float percent-

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[104] For a list of businesses controlled by Hutchison Whampoa, see Hutchison Whampoa, 2008 Annual Report 143 (Mar. 4, 2009), *available at* http://www.htil.com/eng/ir/reports.htm?08ar.

[105] Joanne Chiu & Nerilyn Tenoria, *HK Court Clears Way for PCCW Privatisation*, Reuters.com, Apr. 6, 2009, http://www.reuters.com/article/innovationNews/idUSTRE53531K20090406 and *HK Court Hears Call for PCCW Privatisation Revote*, Reuters.com, Apr. 17, 2009, http://www.reuters.com/article/technology-media-telco-SP/idUSHKG26150020090417.

[106] *See* Williams, *supra* note 57, at 248.

[107] For a full discussion of these matters, see *id.* at 246–49.

ages mean that hostile bids cannot succeed. Further, there is a widespread suspicion that there are tacit "no poaching" policies between the family-run business groups that also suppress interconglomerate competition. Both of these factors inhibit potentially more efficient operators from acquiring underperforming companies. Cross-subsidization of one part of the conglomerate by a "cash-cow" business may also stifle competition. Supporting a nonviable business that would fail were it self-contained has also been a noticeable feature of Hong Kong business practice.[108]

In the commercial sectors that operate on a scale smaller than that in capital intensive sectors, outright cartel agreements are widespread. In recent times, the school text book sector,[109] the motor vehicle instruction market,[110] the building services market[111] and noodle manufacturing[112] have all been subject to naked cartel activity. Simon Pritchard has provided a list of further examples of anticompetitive conduct in the Hong Kong market place:

> The [Consumer] Council found that between 2000 and 2002 Wellcome and ParknShop—the dominant two supermarket chains with an approximate 70% market share—upped average prices by 3.6% cent [sic] during a period when general retail prices fell 5.6%. In a representative case of an industry group regaining pricing power through concerted action, a noodle-makers trade association last year advertised in local newspapers saying it had agreed with suppliers to increase prices by up to 20%. A widespread system of retail price maintenance has product suppliers dic-

[108] For example, Hutchison Group has suffered losses in the 3G business since 2003 with Hutchison Whampoa reporting a profit drop of 42.3% in 2008, *Hutchison Whampoa Profits Tumble 42 percent*, CNN.COM, Mar. 26, 2009, http://edition.cnn.com/2009/business/03/26/hutchison.whampoa/index.html, despite a reported 1% increase in the total revenue of the 3G group. *Hutchison Whampoa Full-Year 2008 Profits Plunge 42%*, IHS GLOBAL INSIGHT, Mar. 26, 2009, http://www.globalinsight.com/SDA/SDADetail16335.htm.

[109] *See* WILLIAMS, *supra* note 57, at 285.

[110] *See City Bus to be Sold to Owner of Main Rival*, S. CHINA MORNING POST, June 10, 2003.

[111] *See Judge Clears Cartel of Fixing Bids to Supply Bates*, S. CHINA MORNING POST, Mar. 17, 2005.

[112] *See Family Grocery Bill Bears the Brunt*, S. CHINA MORNING POST, Nov. 1, 2005.

> tate to retailers a minimum price they must charge consumers. In 2000, the French supermarket giant, Carrefour, withdrew from Hong Kong after just four years, having been blacklisted by suppliers for selling products below the minimum agreed re-sale prices.[113]

Abuses in the consumer sector are the most noticeable manifestation of cartelized markets, but in the commercial sector, property development and property services are also widely acknowledged to suffer severe problems. Restrictive government land-supply policies, as well as land auction rules, have encouraged the consolidation of the major real estate developers. Construction and building services are subject to even more explicit cartel arrangements, and cartelization in those sectors is endemic.

In 2005, a group of property maintenance firms was criminally prosecuted for involvement in a bidding ring to subvert public supply contracts. At trial, they admitted to establishing a joint venture company that coordinated bids and shared excess profits. However, the prosecution failed because the essential ingredient of "dishonesty" could not be proved; the practice was so common in the industry that the legal standard for dishonest intent, as opposed to sharp business practice, had not been breached.[114] This illustrates the scale of collusive business practices in the Hong Kong economy.

Being a small city with a concentrated business elite, the leading entrepreneurs are all well known to each other, and this may well have dampened competition between potential rivals to a significant extent. Coupled with the small scale of the Hong Kong market, these varied factors have led to an ossification of market structure in many

[113] Simon Pritchard, *A Not-Entirely-Free Economy Needs Some New Rules*, HONG KONG J. (2006), *available at* http://www.hkjournal.org/archive/2006_summer/pritchard.html.

[114] Bid rigging with regard to public procurement contracts is illegal under the Prevention of Bribery Ordinance, (1971) Cap. 201 § 6 (H.K.), which provides that anyone who "offers any advantage to any other person as an inducement to or a reward for or otherwise on account of the withdrawal of a tender, or the refraining from the making of a tender, for any contract with a public body for the performance of any work, the providing of any service, the doing of any thing or the supplying of any article, material or substance, shall be guilty of an offence." However, it is quite legal in the private sector. *See Judge Clears Cartel of Fixing Bids to Supply Gates*, S. CHINA MORNING POST, Mar. 17, 2005.

sectors. Cross-subsidization from one part of a business empire to another is facilitated by the fact that subsidiaries are generally not listed companies, thus maintaining the status quo. Taken together the social, economic, political, and legal environments conspire to ensure that competition in many domestic markets is muted or suppressed.

Thus, in Hong Kong, most competition problems are not public sector issues, as they are in Singapore, but private sector issues in which the leading business players also enjoy de facto and de jure political power. As a result, the symbiotic and mutually reinforcing dependency between the government and the tycoons that developed in the colonial era continued after the retrocession of sovereignty of Hong Kong to China. Indeed, the first post-colonial chief executive of the new Hong Kong Special Administrative Region was himself a leading shipping magnate, who clearly identified more closely with the business interests than with the average consumer.[115]

2. THE SLOW DEVELOPMENT OF COMPETITION POLICY This matrix of intertwining economic and political power, facilitated by the functional constituency system, ensured that any suggestion that an antitrust law was needed was met with sterling resistance. Ideological hostility and naked self-interest have served to delay the introduction of a competition law for decades. In fact, no headway was made at all until the last British Governor, Lord Patten, raised the issue in 1992 and commissioned a series of studies into various sectors of the economy.[116] The resulting reports confirmed that areas of concern existed in the sectors that were investigated—energy, banking, the supply of new residential property, supermarkets, and telecommunications. In the 1990s, the government took the brave step of liberalizing the telecommunications sector. Here a single, integrated private sector monopolist, Hong Kong Telecommunications, controlled all domestic and international lines. The introduction of pagers and

[115] *See* Ali Farhoomand & Jeroen van den Berg, *Cyberport: Realisation of an IT Park Through a Public-Private Partnership* (Asia Case Research Centre, University of Hong Kong, 2005), *available at* http://www.acrc.org.hk/promotional/promotional_shownote.asp?caseref=849.

[116] Edward K. Y. Chen & Lin Ping, *Competition Policy under Laissez-Faireism: Market Power and its Treatment in Hong Kong*, 21 REV. INDUS. ORG. (2002).

then mobile telephones effectively eroded the monopoly. However, establishment of a sector regulator, the Office of Telecommunications Authority, with power to authorize new operators and to impose procompetitive licensing conditions later supplemented by statutory provisions,[117] dethroned the monopolist and ushered in a highly competitive market place. In the last fifteen years, the telecommunications sector has evolved into one of the most vibrant and efficient telecommunication industries in the world. Deregulation has facilitated market entry, and the use of sector specific antitrust and merger rules has provided the rules of the competitive game. However, other than in broadcasting, no further significant progress was made between 1997 and 2005 toward enacting a general competition law.

The first post-colonial government rejected the Consumer Council's recommendation to enact a comprehensive competition statute as a matter of urgency.[118] Instead administrative exhortation was adopted to persuade monopolists and cartel operators to voluntarily renounce anticompetitive practices. The Competition Policy Advisory Group (COMPAG) with no investigatory power, no dedicated staff or resources, and no power to sanction was established to provide a fig leaf of respectability to a vacuous policy. A competition policy statement was drafted, guidelines were issued, complaints were received, considered, and then shelved as little or no action could be taken by way of remedy.[119] Some domestic politicians attempted to raise the issue on a sporadic basis as did international organizations and foreign governments, all to no avail.[120]

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[117] *See* Telecommunication Ordinance, c. 106 §§ 7(K), (L), (M), (N) and (P).

[118] *See* Briefing Note for the Provisional Legislative Council Panel on Trade and Industry, Government Response to the Consumer Council's Report on Competition Policy (Nov. 3, 1997), *available at* http://www.legco.gov.hk/yr97-98/english/panels/ti/papers/cp-e!.htm (rejecting enactment of a general competition law).

[119] All documents concerning current competition policy in Hong Kong can be found at the COMPAG website. Competition Policy Advisory Group, http://www.compag.gov.hk/about/.

[120] *See* WILLIAMS, *supra* note 57.

Policy movement on the issue occurred only upon regime change, when a new chief executive, Donald Tsang Kam-kuen, assumed power in 2005. Political charges that the former administration was aligned too closely with the tycoon interests, rather than with the interests of ordinary citizens, stung the new chief executive into forming a Competition Policy Review Committee in 2005.[121]

Although representatives of big business constituted a majority of the Committee's members, it nevertheless opined in favor of a general cross-sector antitrust law but with exemptions for "natural monopolies," which were neither defined nor justified. Merger control was not to be included, and no powers to change the existing industrial structure were to be given to the proposed competition agency.[122] Abuse of dominance and overly restrictive agreements would be targeted but nothing else. Following a public consultation, the government announced, as did the chief executive in his 2007 election manifesto, that a general competition law would be enacted within the new term of the new administration. Consultants were duly appointed to advise the government in mid-2007. A further public round of consultation took place in mid-2008 on more detailed proposals, and a bill was to have been introduced in the Legislative Council at a later date. The program has now been delayed partly as a result of a judicial review challenge to the precise nature of the civil and criminal penalties and how they should be adjudicated.[123] This case has had a direct impact on the proposed enforcement regime. Second, the government apparently needed more time to decide which statutory bodies should be exempted.[124]

Given the longstanding antipathy toward competition policy and the disdain for interference in the pure market mechanism that had been the mantra of successive governments and the business sector

121 *See* Mark Williams, *Competition Policy in Hong Kong: Present Conditions, Future Prospects*, 3 COMPETITION POL'Y INT'L (2007).

122 Report of the Competition Policy Review Committee, Report on the Review of Hong Kong's Competition Policy (June 2006), *available at* http://www.cedb.gov.hk/citb/ehtml/pdf/speech3/CPRC.pdf.

123 Koon Wing Yee v. Insider Dealing Tribunal, [2008] 3 H.K.L.R.D. 372 (C.A.).

124 *Technical issues, supra* note 2.

for so long, this complete change of policy is somewhat surprising. The intriguing question is why the government was converted to the merits of a procompetition policy backed by enforceable legal rules on the assumption of power of the new chief executive. External criticism by international economic bodies and foreign trading partners undoubtedly had some effect. The fact that Singapore defected from the antitrust rejectionist camp in 2005 left Hong Kong very exposed as the only developed economy in the world without a credible procompetition law. Regionally, in addition to Singapore, Korea, Japan, Vietnam, Thailand, and Indonesia had all adopted procompetition regimes for varying reasons and with varying degrees of success in implementation since the Asian financial crisis of 1997–1998. Within greater China, Taiwan adopted a fair trade statute in 1992 and mainland China finally enacted its own Anti-Monopoly Law in 2007.[125]

These developments made defending Hong Kong's exceptionalist position an uphill struggle. Internally, the allegations of favoritism by government towards big business, whether justified or not, created political problems that weakened not only the government's claim to be a neutral umpire of the economic game but its claims of legitimacy, which had been under pressure due to the absence of a democratic mandate. This concatenation of circumstances, allied with the first contested "election" for the chief executive post in 2007,[126] all appeared to point in the direction of adoption. However, powerful business players had been reassured that they would not be disturbed in the quiet enjoyment of their existing positions of economic strength by a too-radical legislative scheme, as there will be neither statutory merger control nor structural powers to require divestiture of business assets that might dismantle conglomerate power.

IV. COMPETITION POLICY—SINGAPORE AND HONG KONG COMPARED

Both Singapore and Hong Kong decided to enact procompetition regimes only in the last few years. In neither case do these enactments

[125] The Anti-Monopoly Law of China came into effect on August 1, 2008. For details, see Global Law and Regulation, http://policy.mofcom.gov.cn/en/claw!fetch.html?id=e07093.

[126] *See* 2007–08 Policy Address, *supra* note 2.

appear to have been based wholly on the acceptance of the intrinsic merits of antitrust laws by their respective governments. Rather, both decisions appear to have been part of a wider political matrix of internal and external factors, unique in each case. The competition problems that both jurisdictions face are similar in nature but derive from very different circumstances. Both economies are small, externally oriented, and very dependent on trade and the servicing of larger hinterlands. Both have relatively isolated domestic markets dominated by home-grown businesses. Both suffer from the affliction of small market economies—high concentration ratios in capital intensive sectors where effective competition is problematic given the need for scale economies. Many sectors in both cities suffer from high barriers to entry of new participants. Both cities have business-friendly governments with pro-enterprise polices, low taxation rates, low corruption rates, efficient governments, reliable commercial law systems, and excellent physical infrastructure in domestic transport, telecommunications and air and maritime facilities. But in relation to competition problems, actual or potential, the fundamental difference between them is the ownership of the firms that dominate the domestic economy. In Singapore, the state is in control, in Hong Kong it is largely the private sector.

V. SINGAPORE'S COMPETITION REGIME

A. The Competition Act 2004

The Singapore Competition Act 2004 (the Singapore Act) came into force in January 2005 with the establishment of the new Competition Commission of Singapore (CCS) though the major prohibitions were not activated until January 2006.[127] During the intervening year, the CCS produced a number of guidelines on implementation of the new law. The merger control provisions were not activated until July 2007. The Singapore Act is largely based on the UK Competition Act 1998, which in turn was substantially modeled on the pre-2004 European Community competition regime. UK law was subsequently substantially enhanced by the competition provisions now contained in

[127] Competition Act, c. 50 B (Sing.), http://www.ccs.gov.sg/Legislation/CompetitionAct/index.html. *See also* Competition Commission Singapore, http://www.ccs.gov.sg.

the Enterprise Act 2002,[128] which criminalized cartels, reformed the merger control regime, reorganized institutional arrangements, revamped the investigatory and remedial structural powers of the UK Competition Commission, enhanced consumer-oriented enforcement and facilitated the abolition of the notification provisions of relevant restrictive agreements in line with the EC Modernization Directive which took effect in 2004.

The Singapore Act does not include any power to require divestiture or to alter market structure. Vertical restrictions on competition are entirely exempted unless they constitute an abuse of a dominant position.[129] Singapore chose a restrictive "follow on" right of private action, which restricted private litigation to circumstances in which the CCS had already made a finding of breach against an errant enterprise.[130] This watered down private enforcement provision is somewhat surprising given that the UK Competition Act 1998 was subject to substantial amendment by the Enterprise Act 2002, whose provisions were available as the Singapore legislation was drafted. The full text of the EC Modernization Directive was also known at the relevant time. The Singapore decision to choose a relatively weak regime can be explained by reference to several factors.

First, the CCS explains that the objectives of the Singapore Act are relatively circumscribed:

> Competition is a key tenet of Singapore's economic strategy. Market competition spurs firms to be more efficient, innovative and responsive to consumer needs. Consumers would enjoy more choices, lower prices, and better products and services. The economy as a whole benefits from greater productivity gains and more efficient resource allocation. Therefore, wherever appropriate, Singapore has opened up sectors of the economy to market competition[,] and introduced sectoral regulation to manage competition issues that arise in these sectors.
>
> Competition policies pertaining to market structure and access, nature and pace of liberalisation and deregulation for each sector of the

[128] Enterprise Act 2002, c. 40, *available at* http://www.opsi.gov.uk/Acts/acts2002/ukpga_20020040_en_1.

[129] Competition Act, Third sched. ¶ 8, excludes vertical agreements.

[130] Competition Act, § 86.

economy will continue to be policies and decisions of the respective ministries and sectoral agencies.[131]

Thus it is clear that adjustment of economic structure is seen squarely as a political matter and not one to be undertaken by the CCS. Government will decide whether industrial structure requires change, not the CCS.

Second, the specific provisions of the Singapore Act and the philosophy underlying the legislation are also comparatively limited. The CCS states on its Web site:

> The [Singapore] Act seeks to prohibit anti-competitive activities that unduly prevent, restrict or distort competition. There are three main prohibited activities under the [Singapore] Act:
>
> - anti-competitive agreements, decisions and practices ("the section 34 prohibition");
> - abuse of a dominant position ("the section 47 prohibition"); and
> - mergers and acquisitions that substantially lessen competition ("the section 54 prohibition").
>
> In its administration and enforcement of the [Singapore] Act, the [CCS] will bear in mind that any regulatory intervention in the market may impose costs. Therefore, the Commission will balance regulatory and business compliance costs against the benefits from effective competition.
>
> Instead of attempting to catch all forms of anti-competitive activities, the [CCS]'s principal focus will be on those that have an appreciable adverse effect on competition in Singapore or those that do not have any net economic benefit. In assessing whether an activity is anti-competitive, the Commission will give due consideration to whether it promotes innovation, productivity or longer-term economic efficiency. This approach will ensure that we do not inadvertently constrain innovative and enterprising endeavours.

Consequently, it can be seen that the Singapore Act is substantially influenced by an economics agenda and contemporary antitrust economic learning.[132] This approach, in many respects, mirrors Ameri-

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131 *See* Competition Commission Singapore, Competition Act c.50 B, Background, http://www.ccs.gov.sg/Legislation/CompetitionAct/index.html.

132 *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (7th ed. 2007).

can antitrust jurisprudence and practice, rather than the somewhat wider scope of European Community competition law.[133] The narrow focus of application of the Singapore Act is reinforced by a number of specific provisions in the statute itself and in the various guidelines subsequently issued by the CCS. The Singapore Act does not apply to industries that have sectoral regulatory regimes that include competition codes—telecommunications, television, newspapers, and electricity.[134] Other exempt sectors include those with alternative modes of regulation, such as postal services, piped potable water, sewerage services, scheduled public bus services, rail services, and cargo operations at the monopolized state-owned Port of Singapore.[135] All government departments and statutory boards are also exempted.[136] Some banking clearing house operations are also exempted.[137]

In addition to these generous exemptions, the conduct provisions are significantly narrower in focus than their European antecedents. Section 47, which prohibits abuse of a dominant position, does not include a reference to the imposition of unfair purchase or selling prices but rather incorporates a narrower concept of "predatory behaviour towards competitors."[138] Further, the threshold test for dominance is set at a sixty percent market share and is much higher that that used in the EC as an indicator of dominance.[139] However, the prohibition does apply to "one or more undertakings," so oligopolies might be caught.[140]

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133 *See* DAVID GERBER, LAW AND COMPETITION IN TWENTIETH CENTURY EUROPE: PROTECTING PROMETHEUS (1998).

134 For an example of a sector-specific competition regulation, see Infocommunications Development Authority of Singapore, Code of Practice for Competition in the Provision of Telecommunication Services 2005, *available at* http://www.ida.gov.sg/Policies%20and%20Regulation/20061010135522.aspx.

135 Competition Act, Third Sched., ¶ 6.

136 *Id.* at § 33(4).

137 *Id.* at Third Sched. ¶ 7.

138 *Id.* at § 47(2)(a).

139 *See* Competition Commission Singapore, CCS Guidelines on the Section 47 Prohibition, at § 3.8, *available at* http://www.ccs.gov.sg/NR/rdonlyres/A67B68FC-DB6F-415B-9DF1-5A97FC6855A9/17206/s47_Jul07FINAL.pdf.

140 Competition Act, § 47(1).

Interestingly, the extraterritorial reach of the Singapore Act extends to undertakings that commit anticompetitive acts or conduct outside Singapore that have an effect on a market within Singapore[141] and to undertakings whose dominant position in a market outside Singapore has an anticompetitive effect on a Singapore market.[142] These provisions are wider than those found in EC or UK legislation and have been explained by Burton Ong as being necessary due to Singapore's small and open economy that is highly reliant on imported products. Clearly, as Ong also mentions, such an exorbitant claim to jurisdiction suffers from severe practical enforcement limitations.[143]

Section 34 prohibits "agreements between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction or distortion of competition within Singapore." While this prohibition is very similar to the original EC provision, there are a number of important modifications. In addition to the sectoral and industry exemptions, all vertical agreements are excluded save that the minister may decide to apply the prohibition by order to specified agreements[144]; this power has not been exercised during the first three years of the Singapore Act's enforcement. However, a vertical agreement may be attacked if the conduct amounts to an abuse of dominance, as mentioned above. This wide exemption has been justified on the bases of reducing compliance costs and that contemporary economic thought considers most vertical agreements to be pro- rather than anticompetitive.[145]

The ability under pre-2004 EC and UK practice to apply to the EC for advance exemption of a multiparty agreement that fell within the prohibition but might be individually exempted on the basis of

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[141] *Id.* at § 33(1).

[142] *Id.* at § 47(3).

[143] *See* Burton Ong, *The Origins, Objectives and Structure of Competition Law in Singapore*, 29 WORLD COMPETITION 269, 283 (2006).

[144] Competition Act, Third Sched., ¶ 8.

[145] *See* Competition Commission Singapore, Useful Info, Frequently Asked Questions, B) Scope of the Competition Act, http://www.ccs.gov.sg/UsefulInfo/FAQs/index.html.

countervailing positive benefits was not followed by the Singapore. This accords with post-2004 EC practice as does the reliance on self-assessment by enterprises alongside the grant of generous block exemptions.[146]

The merger control regime has been enforced only from 2007, and it too was designed to be a light-touch regime.

B. *Scope and effect of the new regime*

It is difficult to provide an accurate assessment of the utility of the Singapore legislation given that it has been in operation for only three years. Clearly, if my analysis correct, a major issue in the Singapore economy relevant to competition is the nature and extent of GLC operations. As structural issues are explicitly outside the scope of the Singapore Act and the CCS has no power to examine or impose structural remedies, save where the section 34 prohibition against "concerted practices" applies to oligopolistic markets, the fundamental issue of existing market structure and ownership of assets will not be affected.

The narrow scope of the Singapore Act, its generous exemptions and exclusions all suggest that the law will provide limited assistance in bringing about significant change in the domestic economy. It will be able to deal with conduct offenses, so some cartels, in particular, may be dismantled. However, in the absence of a political decision to privatize the GLCs or to liberalize regulated industries, the structural status quo ante of the domestic economy will be maintained. The law was very carefully crafted to ensure conformity with current economic thinking about the proper ambit of competition regulation, but the statute and the philosophy of the enforcement agency appear to be specifically designed to demonstrate formalistic compliance with Singapore's international obligations while leaving undisturbed the

[146] Section 41 of the Competition Act sets out the criteria for eligibility for a block exemption. In order to qualify, an agreement must "contribute [ ] to—(a) improving production or distribution; or (b) promoting technical or economic progress, [without] (i) impos[ing] on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or (ii) afford[ing] the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question."

major features of the domestic economy. Adopting a model that conforms to contemporary American-inspired antitrust thinking cannot be held against Singapore by the counterparties to its free trade agreements, but the utilization of a philosophy designed for a continent-sized, dynamic, private sector-dominated economy simply does not fit with the competition issues observed in a small, concentrated, public sector-dominated economy like Singapore's. One can only speculate as to the rationales that have defined the choices of the shape of the regime and the enforcement priorities adopted by the CCS.

The Singapore authorities have presumably decided that a law based on contemporary nostrums promoted by the United States itself will satisfy international opinion as to Singapore's compliance with its voluntarily accepted obligation to enact an antitrust regime, but I suggest that the application of that model to an economy with very different characteristics probably means that the law will have a limited impact on the realities of the Singapore economy. The Singapore government's rhetoric clearly supports the notion that competition fosters innovation and that a total welfare concept is the benchmark by which to judge the success of its competition policy. But implementation of this policy through the mechanism of the Singapore Act may be significantly compromised by government's stance as regards the maintenance of the GLCs' leading role in the economy. This policy tension might be expected to lead to an attenuated enforcement of the Singapore Act given the underlying conflict between a more muscular enforcement of the procompetition regime and the policy imperative of leaving undisturbed the structure of so many domestic sectors of the economy.

If this hypothesis is correct, one might expect that enforcement of the legal prohibitions would be conservative and reactive, rather than active. That does not mean to say that procedure or process would be deficient once an enforcement decision was taken in a particular case. If cases are selected for enforcement action, thorough analysis and efficient handling would be expected, given the government's general culture of administrative efficiency.

However, one might question whether government has a wholehearted conviction that a fundamental change in favor of a more vigorous competition culture should be a major policy priority, given that issues of market access to various sections of the economy and divestiture remedies in monopolized or chronically oligopolistic markets with sluggish competition appear to be out of bounds.

C. Enforcement to date

In the CCS's first year of operation, it produced a plethora of guidelines and a leniency program for cartel whistle blowers. In all, some thirteen guidelines have now been published.[147] They include guidance on the major provisions of the Singapore Act, the principal prohibitions, merger assessment and procedure, market definition, investigatory powers, enforcement, leniency, application for administrative decision on potentially infringing conduct, penalties, the treatment of intellectual property rights, and competition impact assessments of governmental action.[148]

The CCS Annual Report 2006/2007 showed that between January 1, 2006, and March 31, 2007, fourteen complaints were received, together with three notifications for decision and three notifications for guidance. The CCS issued one decision and provided one guidance report. The CCS also worked on the implementation regime for merger notification and assessment and issued a block exemption for liner shipping conferences.[149]

As regards CCS decisions, so far two air service cooperation agreements have been cleared as a result of the net economic benefit, though lack of scrutiny of the hard-core nature of some of the restrictions contained in the notified agreements has been criticized.[150] Two

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[147] Competition Commission of Singapore, CCS Guidelines, http://www.ccs.gov.sg/Guidelines/index.html.

[148] *Id.*

[149] Competition Commission Singapore, Annual Report 2006/2007, *available at* http://www.ccs.gov.sg/NR/rdonlyres/02867DE2-0B44-4EBC-9513-6A3A4B80852B/18779/CCSAR06_07.pdf. *See also* Ministry for Trade and Industry, Competition (Block Exemption for Liner Shipping Agreements) Order 2006, *available at* http://www.ccs.gov.sg/NR/rdonlyres/888159CB-250B-42AE-8580-E7F04273C4CA/10747/BlockExemptionOrderforLinerShippingAgreements.pdf.

[150] *See* Burton Ong, *Competition Law Takes Off in Singapore: An Analysis of Two Recent Decisions*, 3 COMPETITION POL'Y INT'L 101 (2007).

other restrictive agreements have been notified, both of which remain under investigation.[151] The Visa International Agreement has been under consideration for over three years due to parallel investigations in the European Union, relating to multilateral interchange fees.[152] Fourteen merger situations have been notified to the CCS since the merger provisions came into force in July 2007, and all have been cleared. The cleared cases appear to be uncontroversial as none of them seem to raise significant concerns about substantial restrictions of competition in a Singapore market.[153]

On January 9, 2008, the CCS issued its first (and so far, only) infringement decision in respect of a bid-rigging ring in the pest-control market in Singapore.[154] This case involved six pest control companies who jointly rigged bids for tenders to provide termite control treatments at six locations owned by different land owners. The CCS appears to have investigated as a result of an allegation of anticompetitive behavior in relation to one contract and uncovered the other five instances of collusion itself. The incumbent service provider induced the other five providers to submit bids priced above the incumbent's offer to ensure that it would retain its existing contract. On receiving a tip, the CCS made unannounced visits to the six companies, all of which subsequently admitted their involvement in the bidding ring. The value of the contracts concerned was between

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151 For notifications and decisions of the CCS, see Competition Commission Singapore, Public Register, http://www.ccs.gov.sg/PublicRegister/Notifications+Decisions+-+Public+Register.htm..

152 *See* Press Release, European Commission, Commission Sends Statement of Objections to Visa (Apr. 6, 2009), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/151&type=HTML&aged=0&language=EN&guiLanguage=en.

153 For the full text of all merger decisions to date made by the CCS, see Competition Commission Singapore, Public Register, Mergers Decision, http://www.ccs.gov.sg/PublicRegister/Mergers+Decision.htm.

154 Competition Commission Singapore, Notice of Infringement Decision, Collusive Tendering (Bid-Rigging) for Termite Treatment/Control Services by Certain Pest Control Operators in Singapore, Case no. CCS 600/008/06 (Jan. 9, 2008), *available at* http://www.ccs.gov.sg/NR/rdonlyres/9717BB75-C9A2-4390-8949-5FD1781DCBB6/19512/ID_030108WoodstockCCSRegister.pdf.

S$14,000 and S$349,000 (approximately US$10,000 and US$255,000). The CCS imposed fines of between S$4000 and S$94,000 (approximately US$3000 and US$68,000). Criminal penalties are not available for cartel activity under the Singapore Act, though guilty parties can be fined up to a maximum of ten percent of the infringers' Singapore turnover.[155]

The formal decision is lengthy at 154 pages with 480 numbered paragraphs. This is somewhat surprising given that the case was not disputed by the infringers, the sums concerned were relatively small and the matter was without significant legal or factual complexity or controversy. The recitation of evidence appears to be rather lengthy, but the careful analysis adopted is to be applauded. The generous references to UK and EC case law are justified on the basis that this was the first infringement decision, the Singapore regime is largely modelled on these systems, and the definition of key principles will provide a precedent for future cases. The findings of the CCS appear to be sound and thorough as do the application of both legal principles and its own guidelines in determining issues of law and in arriving at the penalties to be imposed.

As this is the only infringement decision rendered to date, it is too soon to generalize about the rigor with which the CCS will use its investigatory powers. From the evidence, the participants appear to have been well known to each other, and the uncovered bidding ring may well have been part of a long-running "mutual assistance" arrangement among these firms. It seems hard to believe that only six contracts were affected by the infringers' antecedent conduct. It is not clear from the decision to what extent the investigation was widened to consider other contracts or the participation of firms in similar schemes in relation to the industry as a whole. It is also not clear whether the CCS has adopted an active approach or merely responds to complaints received. The building/premises maintenance sector is notorious for collusive activity, and so a reasonable inference would appear to be that such anticompetitive acts are a traditional industry-wide practice, rather than isolated incidents. In the UK, the Office of Fair Trading (OFT) announced in April 2008 that it

155 Competition Act §§ 69(2)(d) & 69(4).

had issued formal allegations of bid rigging and other cartel practices against 112 construction firms, including some of the countries largest operators. The OFT's original investigation led to a cascade of discoveries of multiple and varied infringements. The investigation has led to numerous requests for leniency in return for the provision of information. Thousands of tenders are alleged to have been compromised involving very substantial overcharging of public and private sector clients over many years. The investigation is continuing, and it is clearly a very complex and wide ranging inquiry. The OFT now also offers rewards of up to US$200,000 for information that leads to the uncovering of cartel activity.[156] While the CCS is a new agency, the rigorous lateral investigation displayed by its UK counterpart might well represent an enforcement model that could be usefully adopted to make a more significant impact on hidden cartels in Singapore.

A second issue that arises from the bid-rigging decision is a possible defect in the architecture of the Singapore Act. Agenda, the particular chemical agent used by all six firms in this case, has particular characteristics that make it the most efficacious termiticide. The manufacturer has licensed a single exclusive distributor in Singapore. Both the manufacturer and the distributor strictly limit the number of "applicators" who may purchase and apply Agenda. Regular meetings were held between the manufacturer, the distributor, and the six applicators where, among other things, they discussed minimum pricing formulas for Agenda applications. Minimum retail prices were set and enforced by the distributor. Additionally, the parties agreed that they would not poach other applicators' clients by tendering bids lower than the minimum price previously agreed.

As the Singapore Act does not extend to resale price maintenance or any other vertical agreements, the CCS was not required to make any findings in respect of this practice. However, it seems that due to the particularly effective characteristics of Agenda in eradicating ter-

156 *See* Press Release, Office of Fair Trading, OFT Issues Statement of Objections Against 112 Consturction Companies (Apr. 17, 2008), *available at* http://www.oft.gov.uk/news/press/2008/52-08.

mites in both the pre- and post-construction phases of building construction, it was the chemical of choice in many cases. Agenda and another chemical known as "Premise" work by coming into contact with termites that then transfer the poison to other termites in the nest, so eradicating the whole colony. As these colony management agents are more effective than other methods in termite control, they form a distinct product market. Further, the method of application of the termiticide is also crucially important. Use of Premise requires that holes be drilled into existing structures for proper application, whereas Agenda merely requires application at the surface perimeter of the affected site. Thus, Agenda is not only one of the more effective treatments, it is also far easier to apply. Consequently, the CCS considered that these factors, and a longer nonreinfestation warranty offered by the manufacturers, were sufficient to indicate that Agenda may constitute its own product market.[157]

As a result of the marketing arrangements, the nature of the product, and the lack of any prohibition against vertical restrictive agreements, the dominance of the manufacturer of Agenda and its decision to impose resale price maintenance facilitated the downstream collusion between the applicators. While the applicators' activities are caught by the section 34 prohibition, the conduct of the manufacturers and the distributors is not.

Exclusive distribution and resale price maintenance agreements may well be extensive in a small jurisdiction such as Singapore. And while probably not foreseen when the law was drafted, the omission of any control of vertical agreements (save as a manifestation of abuse of a dominant position) may have the unintended consequence of facilitating collusion in downstream markets. In this case, even though the CCS appears to have concluded that Agenda constitutes its own unique market, no investigation or action was considered against the manufacturer or the distributor on the basis that the vertical agreements entered into and their operation constituted a potential breach of the section 47 prohibition against abuse of dominant position.

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157 Competition Commission Singapore, Collusive Tendering, *supra* note 153, at ¶¶ 78–83.

D. Conclusion

The Singapore legislation adopts a narrowly focused economics-driven approach that derives much from U.S. doctrine and policy. While the clear focus of the law is to be welcomed, the narrowness of its ambit, the wide scale exclusions and exceptions, and the fact that existing industry structure is off-limits to the CCS, all raise reasonable questions as to the extent to which the law will bring about significant change in competition conditions in Singapore. The enforcement activity of the CCS to date has been respectable though necessarily limited given the scope of the law, the philosophical orientation of legislation, and the apparent enforcement posture the CCS has adopted. Also, given that the whole system is very new, it is difficult to come to any fair conclusions yet; considerably more evidence is needed before conclusions can be drawn as to the effectiveness of the new regime.

VI. HONG KONG'S COMPETITION REGIME

A. Hong Kong competition proposals

As has been discussed above, Hong Kong does not currently have a general competition law. There are sector specific provisions in the Telecommunication Ordinance[158] and parallel but not identical ones in the Broadcasting Ordinance.[159] I do not propose to discuss these rules as they are slated for repeal upon the enactment of the new general competition law which the government will introduce into the Legislative Council. Instead in this section, I will consider the government's *Detailed Proposals for a Competition Law* (the Proposals) published on May 6, 2008.[160]

Clearly, this discussion will, necessarily, be a tentative one as the precise content of the new statute is, as yet, unknown, as is the

[158] Telecommunication Ordinance, c. 106.

[159] *See* Broadcasting Ordinance, c. 562 §§ 13, 14, 15, 16, 25, 26 & 28.

[160] Commerce & Economic Development Bureau, Detailed Proposals for a Competition Law—A Public Consultation Paper (May 2008), *available at* http://www.cedb.gov.hk/citb/ehtml/Consultation_Paper_Eng.pdf [hereinafter Proposals].

detailed architecture of the competition agencies that will administer it. However, a useful analysis of the Proposals can be undertaken at this stage and, in particular, the significant differences in approach to those adopted in the Singapore system can be discussed.

The Proposals make clear that (unusually) the new law will contain an explicit "purpose" clause. The enhancement of economic efficiency will be the guiding principle. The Proposals do not explicitly make consumer welfare the yardstick, but they do mention "consumer benefit through sustainable competition." Thus, it is unclear whether this is a total welfare concept or a pure consumer welfare standard. The inclusion of the term "sustainable competition" might imply the need to ensure that competitors are kept viable in order to provide competition, but given that efficiency is explicitly stated to be the goal, presumably this phrase should be interpreted as referring to ensuring that exclusionary market entry barriers erected by firms with substantial market power or as a result of government regulation can be effectively tackled by the statutory provisions, the competition agency, or through private litigation.

The structure of the new law will substantially follow EU/UK precedent, as is the case in Singapore. The new Hong Kong Competition Commission (HKCC) will be an independent statutory body in corporate form with a management board which will oversee an executive arm. Concerns expressed by the small and medium-sized enterprise (SME) sector are catered to by the requirement that one of the commissioners should have SME experience. The HKCC will also have the power to advocate procompetition policies to government, propose policy change, educate the public and industry in competition affairs, undertake and fund research, work with competition bodies outside Hong Kong, and the power to conduct inquiries into the functioning of markets.[161]

The Proposals suggest that the HKCC will have all the necessary investigative powers and the ability to impose financial penalties up to a certain limit as well as cease and desist orders. Robust procedural safeguards to ensure the integrity of infringement proceedings by separating investigative from adjudicative functions are suggested.

[161] *Id.*

However, as a result of *Koon Wing Yee v. Insider Dealing Tribunal*,[162] the government is now reconsidering whether the HKCC should be merely an investigator/prosecutor, with cases having to be proved to an independent tribunal, or be a special division of the High Court. A final decision on this issue is yet to be made.[163]

The power to negotiate settlements as well as incentives for whistle-blowing will be provided. As regards the institutional arrangements, HKCC members will be appointed by the Chief Executive, and neither he nor the relevant minister will be empowered to issue directions to the HKCC. Further, the HKCC's executive arm will not be part of the civil service. These institutional arrangements are superior to those in Singapore. As discussed above, the CCS is answerable to the minister who appoints the members, and the executive is staffed with civil servants transferred from other agencies on a temporary basis. This structure inevitably leads to the possibility that, while the CCS is formally separate from government, the linkages are much closer than those proposed for Hong Kong, calling into question its functional independence.

The Proposals also provide for the establishment of a Competition Tribunal with the power to hear and determine appeals from decisions of the HKCC, order higher penalties than those available to the Commission (up to ten percent of the undertakings' turnover), and to order the disqualification of company directors. This is particularly important where most major companies are still family controlled. Disqualification of members of the controlling family from exercising powers of management, directly or indirectly, would constitute a serious deterrent to anticompetitive acts. No criminal sanctions are envisaged. This is probably the correct decision as the difficulties of prosecutorial procedure, the high standard and burden of proof, and existing social attitudes all militate against criminal penalties at this stage in the development of competition policy in Hong Kong. The establishment and powers of the proposed Competition Tribunal are now in some doubt as no final decision has yet been made as to whether it will be reconfigured as a trier of fact with powers to

[162] [2008] 3 H.K.L.R.D. 372.

[163] *Technical issues*, *supra* note 2.

impose penalties or whether those powers will be exercised by the High Court. A final decision is awaited.

The Competition Tribunal will also have the power to hear and determine stand-alone private damages actions and injunctions for breach of the substantive anticompetitive conduct prohibitions. This is in addition to follow-on actions that may be brought by injured parties after the finding of an infraction by the HKCC. A further strengthening of the private enforcement of the law is the provision of "representative" actions by "authorised" bodies on behalf of a group of consumers or traders who have suffered loss or damage as a result of unlawful anticompetitive conduct.[164] These provisions are in marked contrast to the more anemic provisions for private enforcement under the Singapore Act, which are limited to individual follow-on actions. The Hong Kong provisions are clearly significantly tougher and should provide a useful supplement to public enforcement. However, the Hong Kong civil litigation system—no jury trials, no attorney contingency fees, no treble damages, loser-pays-winner's-legal-costs rule—and a very different litigation culture may all conspire to reduce the significance of private enforcement in Hong Kong. This is an inevitable consequence, but it does not mean that private enforcement will be unimportant, although the balance between public and private enforcement will not become clear until several years after the new competition law becomes effective.

The substantive provisions of the new law will closely follow EC and UK provisions, as is true under the Singapore Act. Anticompetitive agreements or concerted practices that have the purpose and effect of substantially lessening competition will be prohibited.[165] The Proposals suggest that undertakings (which are widely defined to include all bodies that engage in economic activities) involved in horizontal hard-core cartel activities will be a principal focus of the legislation and that vertical agreements will be addressed only in the context of an abuse of substantial market power.[166] The law will

[164] *See* Proposals, *supra* note 159, at §§ 33–42.

[165] *Id.* at §§ 24–26.

[166] *Id.* at §§ 26–27.

also address concerted practices in addition to agreements and understandings. In this way, the law will be able to tackle collusive activity in oligopolistic markets. The Proposals recognize that the concentrated nature of the Hong Kong market makes oligopoly conduct a particular problem.[167]

The law will also prohibit abuse of substantial market power, and again the Proposals recognize that in the concentrated Hong Kong market, a small number of firms dominate a number of industrial sectors.[168] Consequently, the Proposals suggest that the threshold for investigation of abuse should be set at the relatively low benchmark of forty percent of the relevant product market. The proposed law will not list specific examples of abuse, and the characterization of infringing conduct will be left to the HKCC to determine in nonstatutory guidance.[169]

These prohibitions are substantially similar to the ones found in the Singapore Act and display a similar philosophy. However, the crafting of provisions to suit the specific characteristics of the Hong Kong market, especially the lower presumptive standard for the exercise of market power, suggest that the government's purpose is to have an effective instrument to deal with the most egregious anticompetitive conduct. It would appear that the Hong Kong legislation will focus on cartels and exclusionary conduct rather than on exploitive abuses by firms with substantial market power. This accords with the Singapore Act and with American practice, but departs from the current position under EC law, especially as regards exploitive abuses.[170]

It should be noted that the HKCC will have the power to exempt anticompetitive conduct or agreements when they provide a net economic benefit.[171] The HKCC will also be able to promulgate block exemptions in respect of categories of agreements or prac-

[167] In particular, see *id.* at § 24.

[168] *Id.* at §§ 24–26.

[169] *Id.* at § 26.

[170] This may be seen as a reform of article 82 of the EC Treaty.

[171] Proposals, *supra* note 159, at § 48.

tices.[172] Both these provisions are similar to the EC, UK and Singapore models and are reasonably uncontroversial.

As regards remedies, which have already been mentioned in the context of institutions, the Proposals provide a number of procedural safeguards to prevent vexatious or unmeritorious private litigation. The Competition Tribunal will have the power to dismiss such cases, and the HKCC will be entitled to intervene in private cases where it considers it appropriate to do so or obtains leave of the Competition Tribunal to get cases stayed pending its own investigation into the alleged infringing conduct.[173]

The existing sectoral competition rules in telecommunications and broadcasting will be repealed and aligned with those in the new general law.[174]

The Proposals are, however, unsatisfactory in several respects. First, a major departure from orthodox competition practice is the government's equivocal position on the inclusion of a merger control regime as part of the new Hong Kong law.[175] This vacillation is partly a result of the hostility toward structural remedies shown by the original Competition Policy Review Committee in 2006.[176] Hopefully the government will be convinced that the absence of a merger control system will render the new law suboptimal at best and may even provide a powerful incentive for oligopoly industry players or cartel operators to merge into a single entity, so avoiding the prohibition against restrictive agreements. The absence of a regime to prevent the creation of ever more concentrated sectors or even outright monopolies would be damaging. This vacuum will also create legal uncertainty as was the case in the EU in the 1980s, when the European Commission attempted to use its existing powers to prevent harmful concentrations without an effective and comprehensive merger con-

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[172] *Id.* at §§ 46 & 47.

[173] *Id.* at §§ 15–19.

[174] *Id.* at §§ 44 & 45.

[175] *See e.g.*, *id.* at § 28.

[176] Competition Policy Review Committee, *supra* note 122, at 41.

trol system.[177] The Hong Kong government response to this criticism appears to suggest that the HKCC's powers to prevent overly restrictive agreements may be framed in such a way as to include agreements to merge. Such a solution, while it may be pragmatically more palatable, would not foster a predictable and legally certain framework within which to prospectively assess the competition effects of mergers. Hopefully government and industry can be persuaded that a merger regime is an essential part of any rational antitrust regime.

Second, the Proposals do not address the vital issue of jurisdictional reach of the new law nor its interaction with the new Chinese Antimonopoly Law. This is very problematic. The jurisdictional issue may be considered overly technical, but the interaction with the mainland law and the Chinese economy is fundamental given Hong Kong's proximity to and integration with Chinese domestic markets. Political difficulties are the probable cause of this omission. Even after a decade of being subject to Chinese sovereignty the relationship between the Hong Kong and mainland legal systems is very problematic. For example, there is still only very limited mutual recognition of civil judgments,[178] and an extensive judicial cooperation agreement does not yet exist in respect of criminal extradition, though Hong Kong has many existing civil and criminal mutual assistance agreements with foreign states. The sensitivity of the issue is presumably the cause of the government's reticence, but this is hardly appropriate. We will have to wait for the draft competition bill before this matter can be assessed more fully.

Third, the proposals contain no power to order divestiture of assets either in oligopoly cases or in relation to abuses of substantial

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[177] See, for example, the effects of the decision in BAT & R.J. Reynolds v. Comm'n and Philip Morris, Cases 142 & 156/84, 1987 E.C.R. 4487, 1988 4 C.M.L.R. 24, which led to the adoption of Council Regulation 4064/89, Merger Regulation, 1990 O.J. (L 257). *See also* D.G. GOYDER, EC COMPETITION LAW 380–85 (3rd ed. 1998).

[178] Mark Williams, Submission on the HKSARG Detailed Proposals for a Competition Law (Aug. 5, 2008), *available at* http://www.cedb.gov.hk/citb/ehtml/pdf/publication/pc_2008_submissions/Professor%20mark%20william s .pdf. *See also* Press Release, Hong Kong Department of Justice, Arrangement on Reciprocal Enforcement of Judgments Signed (July 14, 2006), *available at* http://www.doj.gov.hk/eng/archive/pdf/2006/pr20060714e.pdf.

market power where the very structure of the sector is the root cause of the anticompetitive conduct. This is a grievous omission especially given the structure of the Hong Kong economy and the dominance of the family-owned conglomerates. The omission is presumably the result of intense lobbying by vested interests. Business interests were prepared to accept the prohibition against anticompetitive conduct but drew the line at the imposed restructuring of inherently anticompetitive sectors. It will be left to the HKCC to lobby for increased powers similar to those contained in the UK Enterprise Act, which allows the UK Competition Commission to investigate sectors and to impose asset divestiture orders in appropriate cases.[179] The absence of this power will limit the HKCC's ability to tackle the root of many competition problems. At least the new law will allow sectoral investigations, and this may provide the opportunity to lobby the government to extend enforcement powers if credible evidence confirms that structural imperfections create sluggish or uncompetitive markets.

Fourth, the exclusion and exemption provisions in the Proposals are far too sweeping. The government intends to exempt itself and all its statutory agencies entirely from the prohibition against anticompetitive conduct.[180] This is quite unjustifiable, and no satisfactory rationale for it is given in the Proposals. This proposal is currently being reconsidered as the draft legislation is finalized.[181]

Fifth, the Competition Policy Review Committee recommended that utilities and other similar sectors should be exempted from the competition law.[182] This was a result of blatant special pleading. The government proposes to exempt "services of general economic interest." The phrase is not defined and the industries to be exempted are not listed. Apparently the authority to exempt will be given to the HKCC on application of incumbents. Most utilities are in the hands of

179 *See* Enterprise Act 2002, 2002, c. 40, § 131, *available at* http://www.opsi.gov.uk/Acts/acts2002/ukpga_20020040_en_1..

180 Proposals, *supra* note 159, at § 50.

181 Commerce and Economic Development Bureau, Information Memorandum to Legislative Council Panel on Economic Development ¶ 5 (Mar. 23, 2009).

182 Proposals, *supra* note 159, at § 48.

private sector monopolists with no detailed regulatory regime to deal with investment, capacity, or pricing (save in the electricity industry).[183] This proposal is obscure and lacks coherence. Presumably this matter will be clarified when the draft bill is published.

Finally, the Proposals suggest that the Chief Executive will have the power to grant public policy exemptions.[184] The process is opaque as are the standards to be applied when his discretion is exercised. The Proposals suggest neither a requirement that he consult the HKCC and seeks its expert advice nor whether the Legislature would need to ratify any decision to exercise this discretion. Hopefully this provision will be substantially improved during passage of the bill.

B. *Will the proposed Hong Kong regime be coherent and capable of effective implementation?*

Any assessment of the proposed Hong Kong competition arrangements must necessarily be speculative, given that at as of spring 2009 the language of the new law was not available. However, despite the obvious deficiencies analysed in the preceding section, it is possible to point to a number of features of the suggested system that indicate that the Hong Kong authorities are in earnest in the creation of a system that will take account of some of the specific circumstances of the Hong Kong economy. The clarity of purpose of the legislation is to be welcomed as it gives the new institutions a precise focus and mandate which will facilitate effective enforcement. The economics and evidence-based approach is intellectually coherent and accords with contemporary thinking. The suggested Hong Kong institutional arrangements appear to be more robust than those in Singapore, with less opportunity for real or apparent conflicts of interest to arise. The acceptance that the market is concentrated, so that concerted practices in oligopoly markets, short of agreements or arrangements, are more likely to occur is a realistic assessment of one of the major competition problems observed in Hong Kong. Single firm operators who possess only a forty percent market share may cross the threshold and so be subject to investigation. The crafting of enhanced private rights of

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[183] *See* WILLIAMS, *supra* note 57, at 284–86.

[184] Proposals, *supra* note 159, at § 49.

action and the granting of jurisdiction to the Competition Tribunal (or now possibly the High Court) to hear private claims will improve the protection of the competitive process and again add to the system's effectiveness. These features represent a significant improvement over their Singapore counterparts, where CCS guidelines suggest that an indicative market share of at least sixty percent is required before the CCS would consider a firm to be dominant.[185] Further, Singapore's more conservative approach to private remedies and the assessment of market power lessen the regime's potential effectiveness in that small and concentrated market. An explanation for this dichotomy might be that in Hong Kong oligopoly markets and firms with substantial market power are almost exclusively in the private sector, while such firms are much more likely to be government-linked corporations in Singapore.

It is hoped that the omissions and defects in the current Hong Kong Proposals will be addressed and the regime substantially improved during the legislative process. But even if divestiture powers for the HKCC are not immediately forthcoming, the conduct provisions and the market investigation powers, coupled with the stronger private rights of action, would seem to indicate that the Hong Kong regime may be superior to its Singapore counterpart.

VII. CONCLUSION

Singapore and Hong Kong were both British colonies established to act as imperial trading posts situated at strategic locations in the Far East in the heyday of British political and commercial ascendancy. Both cities have successfully developed into leading international commercial centers now focused on providing value-added services to much larger hinterlands—the greater part of Southeast Asia for Singapore[186] and mainland China for Hong

[185] *See* Competition Commission Singapore, *supra* note 138, at § 3.8.

[186] Singapore's trade with regional partners accounts for one-third of its external trade. *See* Lilian Budlanto, *S'pore Looks to Southeast Asia for Steadying*, JAKARTA POST, Mar. 11, 2008, *available at* http://www.thejakartapost.com/news/2008/11/03/s039pore-looks-southeast-asia-steadying.html?1. For detailed statistical tables of Singapore trade, see Press Release, International

Kong.[187] The two cities are probably the most business-friendly locations in East Asia and compete to host the regional headquarters of global corporations. However, their domestic markets are substantially in the hands of domestic firms. One crucial difference between them is that in Hong Kong the domestic economy is largely in private hands through locally controlled conglomerates, whereas in Singapore the government has continued to play a pivotal, if not dominant role, in capital intensive sectors. This situation has fundamental implications for the design of effective competition law systems in these jurisdictions. In particular, different political imperatives influence the structure of the enforcement agencies, the substantive norms adopted, and the chosen enforcement tools.

In Singapore, the dominant role of the People's Action Party, which has been in government for fifty years, has profoundly shaped Singapore's economic development, and the key decision in the 1960s that the state would play a leading role in economic development is the root cause of the existing ownership structure of the domestic economy. The continued predominant influence of the state is clear from the content of the CCS's own Web site, where it states that "[c]ompetition policies pertaining to market structure and access, nature and pace of liberalisation and deregulation for each sector of the economy will continue to be policies and decisions of the respective ministries and sectoral agencies."[188] Given government control of large sections of the economy through Temasek, this policy pronouncement has particular importance in defining the boundaries within which market forces, as opposed to government policy, will shape the future of the Singapore economy. The structure of the CCS, the substantive provisions of the law, and the enforcement tools adopted all reflect this political-economy nexus.

Enterprise Singapore, Review of 2Q 2009 Trade Performance and Revised Outlook for 2009, http://www.iesingapore.gov.sg/wps/portal/PressRelease?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/My+Portal/Main/Press+Room/Press+Releases/2009/Singapore+External+Trade+March+2009.

[187] Forty-five percent of Hong Kong's trade is with China. *See* LATTER, *supra* note 89, at 8–9.

[188] *See* Competition Act, c. 50B (Sing.), Background, http://www.ccs.gov.sg/Legislation/CompetitionAct/index.html.

As regards Hong Kong, the role of powerful private sector players is the predominant influence on competition policy formation. Not only do the conglomerates control most of the capital intensive sectors of the domestic economy, but they also have direct political representation in the legislative body. The conglomerates' interests have dictated many of the omissions and exclusions from the Proposals but, even so, their ability to influence competition policy is more limited than in Singapore where the state itself is the largest single economic player. The dual role of the Singapore government inevitably creates an underlying conflict of interest. The difficulty of resolving or appropriately balancing the government's role as an economic participant with that of an impartial procompetition referee is more acute in Singapore than in Hong Kong, where the government plays a more limited direct role in the economy. Consequently, Hong Kong's Proposals may have a greater potential to affect economic outcomes in the long run than the Singapore model, as the Hong Kong system may be able to distinguish between the roles of market participant and disinterested regulator more effectively.

The decision to formulate a competition law at this time may well be an attempt by the Hong Kong government to find a way to be economically neutral in disputes between rival conglomerate factions. By creating an independent competition agency to adjudicate claims of economic misconduct, the government may be trying to insulate itself from becoming embroiled in controversies between powerful vested interests. Creating such an umpire may well be part of the solution to the dilemma inherent in Hong Kong's political economy. This view appears to be supported by Professor Lui Tai-lok's conclusions in a recent article on the breakdown of some of the inherent features of the colonial model of governance and the need for the Hong Kong government to find new solutions.

He analyzed the breakdown of some of the inherent features of the colonial model of governance, which was based on a consensus within the business community in favor of a noninterventionist approach towards major policy issues. This cohesion, which underlay the colonial political order, crumbled in the 1990s due to a combination of factors. These included the rise of Chinese businesses and the process of deregulation within major corporations. As a result, the government of Hong Kong Special Administrative Region has been dragged into the rivalry between corporations and inevitably been caught in a double bind of conflicting demands and interests. Professor Lui concludes that the Hong Kong government needs to "find a way to overcome the fragmentation of business interests and forge more broad-based support for its major development policies."[189]

Singapore and Hong Kong can appear to the casual observer to share a number of characteristics, but the nature of their competition policy problems is quite distinct. This article has sought to explain the key features of the two cities' history, economic development, and structure so as to better understand the competition-related challenges they both face and to underscore the importance of understanding the different political economy considerations within which competition policy operates in Singapore and Hong Kong. As both cities are newcomers to antitrust law and its enforcement, it is too soon to say how effective their respective systems will be in improving competitive conditions. However, given the lack of remedial powers to change extant economic structures, the impact of competition law in both cities is unlikely to result in dramatic change, though competition conditions at the margin are likely to improve. Whatever the outcome, the implementation of their new antitrust regimes will be of interest not only to their own populations but also to their world-wide economic partners.

[189] Lui Tai-lok, *How a Fragmented Business-Government Alliance Has Helped Change Hong Kong's Political Order*, 10 Hong Kong J. (2008), *available at* http://www.hkjournal.org/archive/2008_summer/5.htm.

The new Chinese Anti-Monopoly Law: A survey of a work in progress

BY XIAOYE WANG*

The Anti-Monopoly Law (AML) of the People's Republic of China was promulgated at the 29th Session of the Standing Committee of the 10th National People's Congress (NPC).[1] As a competition law scholar and a passionate advocate of the adoption of anti-monopoly legislation in China during the past two decades,[2] I have mixed feelings about the new law. Although the anti-monopoly legislative process was long and convoluted, it has always been my strong belief that China needs an anti-monopoly law and would enact one sooner or later. Anti-monopoly law is a pillar of the market economy, and this has been recognized over the past century in many countries. Competition and the market mechanism are fundamental to strengthening the Chinese economy. An anti-monopoly law is necessary to prohibit monopolistic conduct and facilitate a free and fair competi-

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[1] *See China Adopts Anti-Monopoly Law*, XINHUA NEWS AGENCY (Aug. 30, 2007), *available at* http://news.xinhuanet.com/english/2007-08/30/content_6632075.htm.

[2] I was honored to lecture on antitrust law twice for the Standing Committee of the Ninth and Tenth National People's Congress of the P.R. China.

tion environment for undertakings by creating a level playing field. The AML enactment indicates that China has chosen the market as a fundamental mechanism to allocate resources instead of the previous system of administrative dictates. Therefore, the law's passage should be deemed as a landmark in China's legal and economic reform and development process.

This article outlines the process of the AML legislation, explains the objectives of the law and the institutional architecture of public enforcement and the role of private suits, and considers the special problems of dealing with governmental anticompetitive behaviors and the interface between the implementation of the AML and regulation in some regulated sectors. The article then comments on the substantive provisions of the AML with respect to horizontal and vertical restrictions on competition, merger regulation, and abuses of dominance. Finally, some conclusions are offered on the influences of the law on the Chinese economy and the challenges in the enforcement of the AML.

I. HISTORICAL REVIEW OF CHINESE ANTI-MONOPOLY LEGISLATION

China was a centrally planned economy until the late 1970s. Under that regime, the term "competition" had a pejorative ideological meaning and was regarded as a capitalist monster.[3] The Third Plenary Session of the Eleventh Central Committee of the Communist Party of China in 1978 heralded an era of economic reform. The reform has since then delivered more efficiency, unlocked the people's potential, and changed the traditional hostile attitude toward competition. *The Interim Provisions for Promoting and Protecting Competition in the Socialist Economy*, issued by the State Council on October

[3] Until 1980, competition was still interpreted as "rivals between manufacturers, under private ownership, for the purposes of acquiring economic interests." Competition was deemed as the origin of the "anarchism of manufacturing" in the capitalist world. It was believed that a "national economy can only be developed in a rational and planned approach under the socialist system which is based on public ownership. Under the socialist conditions, the rule of competition and anarchism of manufacturing stop to function." *See* I DICTIONARY OF POLITICAL ECONOMICS 597–99 (Xu Dixin ed., 1980).

17, 1980, was the first normative document to protect competition and regulate government monopolies in China.[4] The *Interim Provisions* stipulated that "in economic activities, with the exception of products exclusively managed by state-designated departments and organisations, monopolization or exclusive dealing is not allowed."[5] Economic reform has accelerated since 1992 after the Fourteenth National Congress of the Communist Party of China (CPC).[6] In 1993, the Second Amendment to the 1982 Constitution stated that "the State implements socialist market economy."[7] Under these conditions, China needs to establish a market order that supports and protects fair and free competition.

Prior to the AML, China dealt with competition-related issues through a series of laws and regulations. The enactment of the Anti-Unfair Competition Law 1993 (AUCL) was the first major step forward in establishing a Chinese competition law system.[8] The AUCL incorporated provisions that address unfair trading practices and certain types of restrictive agreements, abuse of dominance, and administrative monopoly.[9] The Price Law 1997 prohibits "unfair price activities," including collusion to control market price, impeding the interests of other business operators or consumers, selling products

[4] *See Guowuyuan Gongbao* [Official Gazette of the State Council], No. 487, *available at* http://www.competitionlaw.cn/n214c32.aspx [hereinafter Interim Provisions]. *See Wang Xiaoye*, *The Prospect of Antimonopoly Legislation in China*, WASH. U. GLOBAL STUD. REV. 201, 216–17 (2002).

[5] Interim Provisions, *supra* note 4, at art. 3.

[6] The Report of the Fourteenth Central Committee of the Communist Party of China stated that "the objective of China's economic reform is to establish socialist market economy." The report is available in Chinese at http://news.xinhuanet.com/ziliao/2003-01/20/content_697148.htm.

[7] *See* CONSTITUTION art. 15 (1982) (P.R.C.).

[8] Anti-Unfair Competition Law (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993. The law in Chinese is available at http://www.chinalawinfo.com.

[9] *See* Anti-Unfair Competition Law, arts. 6, 23 on forced transactions by public utilities; arts. 7, 30 on administrative monopoly; art. 11 on below-cost sales; art. 12 on tying; and arts. 15, 27 on bid rigging.

below cost in order to eliminate competitors or monopolize the market, and offering the same products or service at discriminatory prices.[10] The Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors 2006 (M&A Rules) provide a basic regulatory framework for mergers and acquisitions by foreign investors. The M&A Rules have one chapter containing four articles devoted to anti-monopoly review.[11]

Nevertheless, these scattered anti-monopoly provisions have many flaws. First, these provisions do not amount to a complete anti-monopoly control system. For example, article 6 of the AUCL prohibits abusive behavior only by public utilities, and the M&A Rules regulate only foreign investors' merging or acquiring domestic enterprises; the M&A Rules do not regulate mergers among domestic enterprises. Second, sanctions and remedies against prohibited behavior are insufficient and ill-designed. For example, the maximum administrative fines for abusive behavior by public utilities are only RMB 200,000, which does not provide the AUCL with effective deterrent force. Third, a major side effect of the lack of a unified anti-monopoly law is that China also lacks a centralized and independent anti-monopoly enforcement authority.

In fact, following the promulgation of the AUCL in 1993, an anti-monopoly law was placed on the legislative agenda of the 8th, the 9th and the 10th NPCs. However, because of ideological influences and immature market conditions, the anti-monopoly legislative process was unduly prolonged. In 2004, the Ministry of Commerce (MOFCOM), as a drafting agency, submitted a draft anti-monopoly law to

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10 *See JIAGEFA* [Price Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 2997, effective May 1, 1998), art. 14, *available at* http://chinagate.cn/english/430.htm.

11 *See* Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, ch. 5, arts. 51–54 (promulgated by the Ministry of Commerce (MOFCOM), the State Assets Supervision and Administration Commission (SASAC), the State Administration of Taxation (SAT), the State Administration for Industry and Commerce (SAIC), China Securities Regulatory Commission (CSRC) and the State Administration of Foreign Exchange (SAFE), Aug. 8, 2006, effective Sept. 8, 2006, *available at* http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=66925 [hereinafter M&A Rules].

the Legal Affairs Office of the State Council. After two years of discussion, the State Council submitted the reviewed draft to the Standing Committee of 10th NPC in June 2006. This draft was again reviewed and revised three times at the Standing Committee of 10th NPC in June 2006, June and August 2007, and was finally enacted on August 30, 2007.[12] The AML took effect on August 1, 2008.[13]

The AML's promulgation is a significant event. It reflects the immense success of the nearly three-decades-old economic reform process in China, and indicates the end of the state-monopolized price system. It also signifies a more pluralistic ownership structure with increasingly greater managerial autonomy of state-owned enterprises (SOEs). Moreover, due to ongoing opening-up policies, the Chinese economy has become integrated into the world economy. These facts necessitate a harmonized trade policy and a free and fair competitive environment, together with a legal system to prohibit monopolistic conduct and to protect competition. The AML, therefore, has become the essential ingredient for the Chinese socialist market economy.

The AML has been in force since August 1, 2008. However, it still lacks a centralized and independent enforcement authority. Moreover, many of the provisions are very general, lacking specificity, implementing regulations, and guidelines, which are essential for the law to be workable. One can therefore envisage that, at the initial stages, anti-monopoly enforcement in China will face tremendous challenges.

II. LEGISLATIVE OBJECTIVES AND ENFORCEMENT OF THE AML

Clarification of legislative objectives is of particular importance to lawmaking; designing and establishing an appropriate enforcement body is of particular importance to law enforcement. However, the current AML fails to provide satisfactory answers to both of these issues.

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[12] The records of the three revisions and discussions on the proposed anti-monopoly law by the Standing Committee of NPC are available at http://www.npc.gov.cn/englishnpc/news/index.htm.

[13] *See* Anti-Monopoly Law (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), art. 57 [hereinafter AML].

A. Legislative objectives

The objectives of the antitrust law have been hotly debated in many jurisdictions over the years. Mainstream German scholars believe that antitrust law should aim to protect competition itself.[14] In contrast, the Chicago school has championed the view that antitrust law should achieve only economic efficiency.[15] At present, however, there exists consensus among many regimes that the direct objectives of antitrust law should be to prohibit monopoly and protect market competition while its ultimate objectives are to improve economic efficiency and to increase the consumer welfare.

The AML also follows this trend and states: "This Law is enacted for the purpose of guarding against and prohibiting monopolistic conduct, safeguarding fair market competition, improving economic efficiency, protecting the interests of the consumer and public interests, and promoting the healthy development of the socialist market economy."[16] In my opinion, prohibiting monopolistic conduct and safeguarding fair market competition should be deemed as the direct objectives of the AML, while economic efficiency, consumer welfare, public interests, and the healthy development of the socialist market economy should be deemed as the ultimate goals of the AML.

As regards economic efficiency, Chinese understand it to be allocative efficiency and productive efficiency. Undoubtedly, market competition is able to improve efficiency, thus augmenting social and consumer welfare. However, the concept of public interests mentioned in AML is controversial. Some people might believe that public interests refer to consumer interests, and others might believe the concept refers to state interests. In any event, public interests should not represent the interests of particular individuals, enterprises, or groups, and it can be both an economic and a noneconomic concept.

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[14] Ordoliberalism in Germany holds that competition law should create and protect the conditions of competition. It follows from this that competition is a value in itself and not a means by which purely economic objectives—such as efficiency—are to be achieved. *See* Alison Jones & Brenda Sufrin, EC Competition Law, 34–35 (3d ed. 2008).

[15] *See id.* at 23.

[16] AML, art. 1.

Because of its vagueness and flexibility, public interests as a concept has been incorporated into many Chinese laws, normally implying restraint on economic freedom.[17]

It was to be welcomed that explicit protection of undertakings as one of the goals of the AML was removed during the AML's second review by the Standing Committee of 10th NPC in June 2007.[18] However, the AML keeps the concept of "public interest" and parallels it to "the interests of consumers." This approach weakens the AML's ability to improve consumer welfare. For example, according to articles 15 and 28 of the AML, undertakings may present "public interests" as the reason for an exemption for monopoly agreements or anticompetitive concentrations. But, in practice, what kind of business operators are more likely to request such exemptions? State-owned large companies are the obvious examples. Other provisions in the law may favor such entities as well. For example, the AML states: "With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security or the industries implementing exclusive operation and sales according to law, the State shall protect the lawful business operations conducted by the business operators therein. . . ."[19] The AML also provides that "Business Operators may, through fair competition, elect to form [joint ventures] and lawfully consolidate in order to expand their operational scope and increase their market competitiveness."[20] It seems that the AML provides an industrial policy that may guide its implementation: "The State shall make and implement competition rules suitable for the socialist market economy, perfect the macro con-

[17] For example, art. 13 of the Constitution of People's Republic of China states: "The State may, in the public interest and in accordance with law, expropriate or requisition private property for its use and shall make compensation for the private property expropriated or requisitioned." CONSTITUTION art. 13 (1982) (P.R.C.).

[18] *Compare* current AML art. 1 *with* AML Draft submitted by the State Council to the Standing Committee of NPC in June 2006 [hereinafter AML Draft]. *See* DETAILED EXPLANATION OF THE AML OF CHINA 296 (Wang Xiaoye ed. 2008).

[19] AML, art. 7.

[20] *Id.* at art. 5.

trol, and improve a united, open, competitive and well-ordered market system."[21]

It is not necessarily wrong to protect the legitimate interests of SOEs. Actually, any kind of legitimate interest should be protected by law. However, in the absence of a primary objective, it would be difficult to know how the AML enforcer would deal with a conflict between public interest and consumer welfare. For example, consumers naturally wish to have more choices and thus would like to see more competitors in the marketplace. In contrast, the government might encourage undertakings to expand their scale of operation through mergers, in order to establish national champions, and thus might request the AML enforcer to exempt such concentrations from the AML based on public interest.[22]

Of course, conflicts among competing objectives also exist in other jurisdictions. The European Commission's (EC) Discussion Paper on the application of article 82 to exclusionary abuses emphasizes: "[T]he objective of article 82 is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources."[23] The question is whether the objective of EC competition law is protection of competition or improving consumer welfare and economic efficiency. Owing to the EC's vigorous enforcement of competition law, the conflict between objectives may not result in undue compromise of competition law enforcement.

However, the conflict between objectives in the AML is crucial for two reasons. First, the AML is heavily influenced by industrial policy.[24] On the occasion of reviewing monopoly agreements and concentrations among undertakings, the enforcer might consider competition policy and industrial policy simultaneously. Second, the current AML

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[21] *Id.* at art. 4.

[22] *See id.* at arts. 5 & 28.

[23] *See* European Comm'n, DG Competition Discussion Paper on the Application of Article 82 to Exclusionary Abuses at ¶1.1.4 (Dec. 2005), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf.

[24] *See* AML, arts. 4, 5 & 7.

enforcement agencies lack independence.[25] Therefore, I am not confident that the AML is an absolute agent of competition enhancement. How will the AML perform? We have to wait for concrete cases.

B. *Anti-monopoly enforcement bodies*

The AML was formally on the legislative agenda for the 8th, 9th, and 10th National People's Congress.[26] In the years since 1994, China has witnessed a protracted struggle in the legislative process due to political, economic, social, and cultural conditions. However, the division of anti-monopoly enforcement powers between several agencies and the lack of a powerful and unified agency to advocate a competition culture was a major reason for such legislative delays. Unfortunately, the AML does not improve the multiagency status quo, and the enforcement power of the AML is still divided between the Ministry of Commerce (MOFCOM), the State Administration for Industry and Commerce (SAIC) and the National Development and Reform Commission (NDRC).

Considering the enforcement structure, the AML provides that an Anti-Monopoly Commission (AMC) shall be established under the State Council.[27] If a party is dissatisfied with a decision made by the Anti-Monopoly Enforcement Agencies (AMEA), it may apply for administrative reconsideration or file for administrative litigation.[28] Furthermore, the AML provides that undertakings that violate the provisions of the law and cause damage to others shall bear civil liability.

1. A THREE-PILLAR ADMINISTRATIVE ENFORCEMENT FRAMEWORK

The AML does not explicitly provide which agency or agencies are to undertake AML enforcement, merely stipulating that "the AMEA empowered by the State Council shall be responsible for the anti-

[25] *See* Wang Xiaoye, *Highlights of China's New Anti-Monopoly Law*, 75 ANTITRUST L.J. 144–46 (2008).

[26] With the establishment of the Chinese anti-monopoly drafting panel in August 1987, enactment of the anti-monopoly legislation took almost twenty years.

[27] AML, art. 9.

[28] *Id.* at art. 53.

monopoly law enforcement."[29] However, Mr. Cao Kangtai, Director of the Legislative Affairs Office of the State Council, at the time of submitting the anti-monopoly law draft to the Standing Committee of 10th NPC in June 2006, stated: "[T]here exist consensus among interested parties that, regarding the design of the anti-monopoly enforcement structure, current structure should be maintained in order to ensure anti-monopoly law enforcement. On the other hand, the design should be forward-looking and should leave space for future agency reform and restructuring. It is suggested that the anti-monopoly law only stipulates the enforcement authority's responsibilities and working procedure, but leaves the question of which agency(ies) will be empowered to enforce the law to the State Council to stipulate separately."[30] This statement implies that, at the early stage of AML enforcement, the division of enforcement authority among MOFCOM, SAIC, and NDRC will be maintained. Below is a brief review of the three agencies' anti-monopoly powers.

The anti-monopoly jurisdiction of MOFCOM originated from the M&A Rules to oversee foreign mergers with and acquisitions of domestic enterprises.[31] The AML expands the merger review authority of MOFCOM to all transactions subject to notification. The current department responsible for merger review under MOFCOM is the Anti-Monopoly Bureau (AMB).[32] The most notable case today is the proposed acquisition of Huiyuan Juice Group Ltd., a Chinese juice producer, by Coca-Cola Co. for US$2.4 billion. "As soon as [we receive] the relevant application, we will immediately conduct proceedings according to the relevant regulations of the anti-monopoly

[29] *Id.* at art.10.

[30] Statement of Cao Kangtai, Standing Comm. Nat'l People's Cong. (June 24, 2006), Chinese version available at http://www.npc.gov.cn/wxzl/gongbao/2007-10/09/content_5374671.htm.

[31] *See* M&A Rules, *supra* note 11, at art. 10.

[32] The AMB may be deemed to be the successor to the Anti-Monopoly Investigations Office (AMIO) under MOFCOM. In March 2007, the AMIO published *Guidelines on Anti-monopoly Filings for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*. These guidelines are still helpful for the notification of mergers and acquisitions under the AML.

law," Commerce Ministry spokesman Yao Shenhong was quoted as saying.[33]

The anti-monopoly jurisdiction of SAIC originated from the AUCL. As mentioned above, the AUCL prohibits both unfair trade practices and anticompetitive behavior. For example, the AUCL provides that "public utilities or other operators having monopolistic status according to law shall not force others to buy designated goods and therefore exclude other operators from fair competition."[34] In 1993, the SAIC promulgated *Provisions on Prohibition of Public Utilities from Restrictive Conduct against Competition*, which listed a number of prohibited restrictive behaviors.[35] In August 1994, the SAIC established the Fair Trade Bureau, which was charged with investigating market actors' trading behaviors for implementing the AUCL. After the implementation of the AML, the Fair Trade Bureau changed its name to Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau. The new Bureau is responsible for AML enforcement against monopoly agreements and abuses of dominant market position (excluding monopolistic pricing behavior), together with abuse of administrative power to restrict and eliminate competition.[36]

The anti-monopoly powers of NDRC originated from the Price Law. The Price Law prohibits operators from colluding to control market price[37] and empowers the price authority of the State Council to engage in price administration and investigation.[38] The NDRC depart-

[33] Joe McDonald, *China Promises Review of Coke Bid for Huiyan*, ABC NEWS, http://abcnews.go.com/Business/WireStory?id=5776771.

[34] AUCL, art. 6.

[35] Chinese version available at http://www.gaaic.gov.cn/E_Readnews.asp?NewsID=227.

[36] As to the responsibility of SAIC for enforcement relating to abuse of administrative power to restrict and eliminate competition, see AML, art. 51: "Where any administrative agency or organization . . . engages in conduct that eliminates or restricts competition by abuse of administrative power, its superior agency shall order it to make correction. . . . The AMEA may make proposals to the relevant superior agency . . . on handling of the case in accordance with law."

[37] *See* Price Law, art. 14 (1).

[38] *See id*. at art. 5.

ment in charge of investigating price cartels and other monopolistic pricing practices is the Department of Price Supervision. The NDRC promulgated the *Interim Provisions on Prohibition of Monopolistic Price Behavior* in 2003. During the draft review of the AML at the Standing Committee of 10th NPC, the NDRC investigated and prohibited an instant noodle price cartel initiated by an instant noodle association.[39]

The multiagency enforcement structure has been subject to significant criticism.[40] Compared with a single enforcement agency, the three-pillar structure implies high administrative costs and low efficiency, because limited resources have to be distributed among three agencies. Moreover, potential conflicts and friction will arise among the agencies, when, for example, a dominant undertaking colludes on price and engages in forced transactions at the same time. According to the AML enforcement structure, price collusion should be investigated by the Department of Price Supervision under the NDRC, while forced transactions should be investigated by the Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau under SAIC. Such allocation of administrative resources is obviously inappropriate.

Finally, a major flaw in the three-pillar structure is that the AMEA is located at a level in the administrative hierarchy lower than that of a ministry. Such a lowly status will render the AMEA incapable of investigating dominant undertakings and tackling sector-specific restrictive behavior, such as those in the telecom and the banking sectors, given that these sectors are sponsored by powerful ministerial-level agencies. Furthermore, the NDRC is the most important macroeconomic regulator in China, responsible for national security and industry policy. These portfolios may present multiple conflicts of interest. Many previous NDRC rules conflict with competition policy. For example, *Provisions on Prohibition of Below-Cost Sales 1999* provides that "below cost prices, for the purpose of the Provisions, refer to prices below reasonable individual cost. When individual cost is difficult to compute, the governmental price department should deter-

39 *See* NDRC, Notice of the Investigation on Price Collusions among Instant Noodle Producers (2007), Chinese version available at www.ndrc.gov.cn/xwzx/xwtt/t20070816_154071.htm.

40 *See* Wang, *supra* note 25, at 144–46.

mine the cost according to the average cost of the goods in question and the scope of price decrease of the goods in the market."[41] This rule implicitly limits undertakings' autonomy on pricing. Therefore, one may ask whether, under such a system, the NDRC Department of Price Supervision, as part of the AMEA, could maintain sufficient independence to promote a procompetitive outcome.

2. THE AMC UNDER THE STATE COUNCIL In consideration of the division of enforcement powers, the AML provides that the State Council shall establish the AMC in charge of organizing, coordinating and guiding anti-monopoly work.[42] The AMC performs the following functions: (i) formulating competition policies; (ii) organizing the investigation and assessment of the status of market competition as a whole and publicizing an assessment report; (iii) formulating and publishing the anti-monopoly guidelines; (iv) coordinating the anti-monopoly enforcement work of the AMEA and other competent administrative institutions; and (v) other functions assigned by the State Council.[43]

Establishment of the AMC is imperative as compensation for the absence of a unified anti-monopoly enforcement agency in China. Along with the implementation of the AML, the State Council established the AMC and approved its Working Rules in September 2008. Vice Premier Minister Wang Qishan, as Chairman of AMC, organized the first meeting of AMC in September 2008 to arrange the AMC work in accordance with the AML for the next step. According to the Working Rules, the AMC will appoint experts in the field of antirust law and economics as consultants and will establish a consultant expert group.[44]

3. THE AMEA AT THE LOCAL LEVEL Although the AML clearly provides that the law should be enforced centrally by the AMEA under the State Council, the AML also stipulates that the AMEA can authorize "the corresponding organs of the people's government at

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[41] *See* NDRC, Provisions on Prohibition of Below-cost Sales (1999), art. 5, Chinese version available at http://jjs.ndrc.gov.cn/zcfg/t20070727_150273.htm.

[42] *See* AML, art. 9.

[43] *Id*.

[44] *Working Rules,* Chinese version available at http://www.cctime.com/html/2008-9-14/2008914163399261.htm.

provincial level" to be in charge of the AML enforcement within their jurisdiction.[45] Taking into account the geographical size of China and the possibly heavy workload of one-stop AML enforcement, it is mandatory that the AMEA establish local branches across China.

However, due to the fact that the AMEA at the central level is not a unified agency, the AMEA local branches will be those relevant departments at the provincial level having a vertical relationship with MOFCOM, SAIC and NDRC. This fragmented administrative structure would aggravate the difficulty of ensuring consistent and unified application of the AML.

4. ADMINISTRATIVE RECONSIDERATION AND JUDICIAL REVIEW

According to the AML, interested parties can request administrative reconsideration as the first means of challenging a decision of the AMEA on a concentration of undertakings based on articles 28 and 29. If the parties are not satisfied with the reconsideration, they can then resort to administrative litigation, by bringing an action to challenge the decision before a people's court. As regards AMEA decisions on restrictive agreements and abuse of market-dominant position, parties may choose to apply for administrative reconsideration or directly bring an action to challenge the decision.[46]

As one can see, administrative reconsideration is a prerequisite for administrative litigation in anti-monopoly review of mergers, though not in other cases. Although such an approach may be appropriate given the complexity and specialization of merger review, one cannot ignore the lobbying activities by MOFCOM during the process of the legislation. Compared with administrative reconsideration, judicial review is a more appropriate appeal mechanism given that the judiciary is a more impartial referee for the parties. According to *Administrative Procedure Law 1989*, the court of first instance for AML administrative litigation should be the Intermediate People's Court in Beijing and other intermediate people's courts at the municipal level where the AMEA or the AMEA local branches are situated.[47]

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[45] *See* AML, art. 10, ¶ 2.

[46] *See id.* at art. 53.

[47] *See* Administrative Litigation Law, art. 14. *available at* http://www.cecc.gov/pages/newLaws/adminLitigationENG.php.

As the AML has been at initial implementation stage, the people's courts and judges have played only a marginal role in anti-monopoly issues. Nevertheless, after accumulating judicial reviews of anti-monopoly decisions, one hopes the people's courts would improve their understanding of anti-monopoly issues and would become major players in protecting market competition.

5. PRIVATE ENFORCEMENT In November 2004, Sichuan Dexian Technologies Co. (Dexian), a battery manufacturer, brought unfair competition proceedings against Shanghai Sony Guangdian Electronics and Sony Corp. (Sony) to Shanghai First Intermediate People's Court.[48] Dexian claimed that Sony utilized intelligent recognition techniques in its digital cameras and camcorders, ensuring that only Sony batteries could be used in these devices, thus amounting to unlawful bundling. Dexian further claimed that Sony held a dominant market position in the Chinese market for digital cameras and camcorders.

Dexian requested that Sony stop utilizing its intelligent recognition techniques. Dexian believed Sony intended to exclude competitors from supplying batteries for cameras and camcorders by rendering alternative suppliers' batteries unusable. Shanghai Intermediate People's Court accepted the case to be judged in accordance with article of the 2 AUCL, which states: "An operator shall, in transactions in the market, follow the principle of voluntariness, equality, fairness, honesty and credibility, and observe generally recognized business ethics."

In 2007, the Court issued a decision in favor of Sony based on this article, although the case was in essence an anti-monopoly dispute. Dexian made a statement that had the AML been in force at the time of the lawsuit, Dexian would have won the case.[49]

With regard to private enforcement, the AML provides only a general rule: "The undertakings that violate the provisions of this law and

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[48] Hou Zhihong, *Sichuan Dexian Sued Sony in Shanghai for Monopolizing Behavior*, CHINA SECURITIES DAILY (June 30, 2006).

[49] *See* Xiao Liming, *The AML Against Abusive Behaviors Involving Intellectual Property Should be Adopted as soon as Possible*, Chinese version available at http://npc.people.com.cn/GB/53049/6085086.html.

cause damage to others shall bear civil liability."[50] The AML is silent on whether AMEA administrative decisions are prerequisites for seeking AML civil compensation. In theory, there should be no such limit because, considering the limited public enforcement resources available, private litigation could be a powerful tool for competition advocacy.

Nevertheless, private enforcement has its own problems. Private suits might foster unmeritorious and indiscriminate litigation. For plaintiffs, the most serious problem is the difficulty in obtaining sufficient evidence to prove the case. Moreover, it is doubtful that ordinary courts are capable of reviewing anti-monopoly cases that require rigorous economic analysis. Whether or not China should encourage AML private enforcement depends on a balancing of its social costs and benefits. In this respect, China should closely observe the development of private enforcement in other regimes, in particular those in civil law jurisdictions.

III. ADMINISTRATIVE MONOPOLY AND REGULATED INDUSTRIES

The AML protects free competition.[51] The free competition concept encompasses freedom from both private and government restraints. However, no country in the world is completely free from government intervention in its economy. This is especially so for a state in economic transition such as China, where separation of governmental functions from enterprise management has not yet been completed. Most key industries are still controlled by dominant SOEs, and governmental restrictions on competition are common phenomena.

A. Administrative monopoly

Administrative monopoly is a well-known phenomenon in China and concerns government departments as well as their subordinate

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[50] *See* AML, art. 50.

[51] Article 1 of the AML mentions only "safeguarding fair competition." But, considering that the AML should pay more attention to restraints on competition, the goal of the AML should actually be "safeguarding free competition." *See* Wang Xiaoye, *Unfair Competition and Anti-Competition*, *in* Competition Law and Policy in Asia 36–49 (Masao Ogawa & Iwakazu Takahashi eds., 2005).

organs abusing their administrative power to restrict competition. Chapter V of the AML lists behaviors that are characterized as administrative monopoly, including forced transactions, hindering free movement of goods among different regions, exclusive or restrictive behavior in local bidding activities, restrictions on investment and establishment of subsidiaries in local markets, forcing undertakings to engage in prohibited monopolistic conduct, and promulgating rules which eliminate or restrict competition. All said conduct is prohibited. No matter how administrative monopoly manifests itself, in essence, it is a kind of discriminatory behavior that distorts competition, restricts establishment of a unified, open and competitive nationwide market, and thus impedes efficient allocation of resources. Therefore, prohibiting administrative monopoly is a crucial task for the AML.[52]

Although the AML generally prohibits administrative monopoly, and it is of central importance to suppress this type of conduct, the AMEA has not secured substantial jurisdiction over administrative monopoly. The AML states: "Where any administrative agency or organization . . . engages in conduct that eliminates or restricts competition by abuse of administrative power, its superior agency shall order it to make correction."[53] This provision renders the AML prohibition against administrative monopoly a "paper tiger." Similar rules already exist in the AUCL,[54] but rarely has a superior agency overruled decisions made by a subordinate agency. As an improvement compared with the AUCL of 1993, the AML provides that the AMEA may make proposals on the handling of a case concerning administrative monopoly to the relevant superior agency.[55] But, due to the fact that the decision can be made only by the relevant superior agency, this improvement does not function as a sufficient deterrent to administrative monopoly.

In my view, China should not rely on superior agencies to supervise and investigate their subordinate agencies' restrictive behaviors

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52 *See* Wang Xiaoye, *The Prospect of Antimonopoly Legislation in China*, 1 WASH. U. GLOBAL STUD. L. REV. 201, 210–13 (2002).

53 AML, art. 51.

54 *See* AUCL, arts. 7 & 30.

55 *See* AML, art. 51.

for two reasons. First, administrative monopoly, in essence, is a type of discriminatory behavior, and the economic incentive behind such behavior is protection of local undertakings or SOEs. Therefore, it would be difficult for the superior agencies to act impartially in the face of disputes between their subordinate agencies and non-local undertakings or private enterprises. Second, for every agency there is a superior agency. Therefore, the "superior agencies" are neither specified nor professionally trained in anti-monopoly law. Consequently, it would be difficult for the officers of the superior agencies to have a good understanding of competition policy and law.

Prohibition of administrative monopoly, undeniably, is a difficult task for any country, since this prohibition signifies control of the government itself. This task is particularly necessary in China, because the separation of governmental administration from enterprises' management has not been fully accomplished, so the government is interested in protecting SOEs. One can, therefore, predict that the AML will not exert great influence on administrative monopoly.

Nevertheless, the provisions on administrative monopoly of the AML have reflected the mainstream opinion against administrative monopoly in China and the legislators' determination to prohibit it. These rules, without doubt, will facilitate competition advocacy and competition culture and therefore will promote awareness of anti-monopoly spirit among officials at all levels. After the AML took effect on August 1, 2008, the first lawsuit was filed against the State Administration of Quality Supervision, Inspection and Quarantine (SAQSIQ). Even though this law suit was rejected by an intermediate court in Beijing, it has shown that ordinary Chinese people pay much attention to administrative monopoly.[56]

B. Interface between the AML and regulations

The prohibition against abusive conduct in the AML is specifically directed at business operators with a dominant or monopoly market position. In China, numerous incumbent monopolists exist in the sec-

[56] *See Chinese Court Turns Down First Antimonopoly Case*, China Int'l Elec. Comm. Network (Aug. 9, 2008), *available at* http://en.ec.com.cn/article/bizpolicy/bizpolicylawsregulations/200809/688919_1.html.

tors of telecommunications, post, railway, electricity, banking, and many others. Almost every state-owned monopolist has been supervised by an industrial regulator based on a law or regulation. For example, the Telecommunications Regulations stipulate that "the supervision and regulation of the telecommunication industry shall be based on the principles of separation of government administration from enterprise management, elimination of monopoly, encouragement of competition and promotion of development, as well as the principle of openness, fairness, and impartiality."[57] This means that the jurisdiction of the AMEA over the anticompetitive conduct in the regulated sectors might bring about difficult political issues.

According to the draft submitted by the State Council to the Standing Committee of the NPC in 2006, "If there are relevant laws and administrative regulations stipulating that the monopolistic conduct prohibited by the Law shall be investigated and handled by other relevant departments or supervisory organs, those laws or regulations are to be applied."[58] However, due to regulatory capture, in particular that emanating from consideration for the state ownership or state control of the regulated monopolists, the regulators might find it difficult to be neutral or independent when they handle disputes between incumbent monopolists regulated by them and consumers or other business operators. Moreover, industry regulators normally focus on technical problems or product safety, having less experience in competition policy.

Thus, in my view, the AMEA should be given decisive authority to enforce the AML, including the authority in the regulated industries. Under the German Telecommunication Law, the regulatory authority for the telecommunication and postal sector is responsible for preventing abusive behavior. Nevertheless, the Federal Cartel Office liaises closely with the regulator in matters of market definition and market position. Moreover, competition enforcement in other regulated sectors, like electricity and gas, is the responsibility only of the

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[57] *See* Telecommunications Regulations, art. 4 (promulgated by the State Council Sept. 25, 2000), *available at* http://tradeinservices.mofcom.gov.cn/en/b/2000-09-25/18619.shtml.

[58] *See* AML Draft, *supra* note 18, at art. 44.

Federal Cartel Office.[59] In other countries, like the United States, the relationship between competition laws and regulated (or formerly regulated) industries has proved to be a difficult topic for the courts to handle.[60]

There is no provision in the AML explaining the relationship between the AMEA and other regulators. It would, therefore, be preferable for the issue to be clearly expounded by the State Council or the AMC, as the institution responsible for organizing, coordinating and guiding anti-monopoly work. It is recommended that the State Council make the authority of the AMEA clear in this respect. If, however, the Council decides not to grant the AMEA clear and decisive jurisdiction over the anticompetitive conduct in regulated industries, the resulting uncertainty may keep a large part of the domestic market outside the effective scope of the AML.

IV. HORIZONTAL RESTRICTIVE AGREEMENTS

Primarily based on the European competition law, and particularly the German Act against Restraints on Competition,[61] chapter II of the AML distinguishes between horizontal and vertical agreements. Article 13 specifies that the following monopoly agreements between competitors are prohibited: (i) fixing or setting minimums for product prices; (ii) restricting the output or sales volumes of products; (iii) allocating markets; (iv) restricting the purchase of new technology or new facilities or the development of new technology or new products; (v) jointly boycotting transactions; and (vi) other monopoly agreements determined by the AMEA.

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[59] GLOBAL COMPETITION REV., HANDBOOK OF COMPETITION ENFORCEMENT AGENCIES 57 (2003).

[60] There are numerous cases, too many to cite, in the United States courts, and the Federal Trade Commission has struggled with regulated and quasi-regulated industries under court-made doctrines such as the filed-rate and state-action doctrines. *See*, *e.g.*, Cal. Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) (state action); Parker v. Brown, 317 U.S. 341 (1943) (state action); Keogh v. Chi. & Nw. Ry. Co., 260 U.S. 156, 163 (1922) (filed-rate doctrine).

[61] Gesetz gegen Wettbewerbsbeschränkungen, GWB [Act Against Restraints on Competition], Aug. 28, 1998, at chaps. I & II, *available at* http://www.iuscomp.org/gla/statutes/GWB.htm.

According to article 15 of the AML, the prohibition against monopoly agreements, including horizontal and vertical agreements prohibited by articles 13 and 14, shall not apply if the undertakings involved can prove that the agreements are for the purpose of (i) improving technology, or researching and developing new products; (ii) upgrading product quality, reducing cost, enhancing efficiency, unifying specifications and standards of products, or implementing a division of labor based on specialization; (iii) improving operational efficiency and enhancing the competitiveness of small and medium-sized undertakings; (iv) realizing social public interests such as energy conservation, environmental protection, and disaster relief; (v) during a period of economic depression, moderating serious sales decreases or production surpluses; (vi) safeguarding the legitimate interests of foreign trade and economic cooperation; or (vii) other circumstances as stipulated by law and by the State Council. The last is a sweeping clause that enables the AMEA to exempt restrictive agreements not specified by the AML.

Paragraph 2 in article 15 further stipulates that for exemption from the application of articles 13 and 14, the undertakings involved must prove that the agreements will not substantially eliminate competition in the relevant market, and consumers will be able to share the benefits derived from such agreements. The rule for exemption in article 15 is obviously modeled on European competition law.[62] In this case, although article 13 of the AML does not explicitly adopt a per se rule regarding hardcore cartel activity, such as price fixing, output restricting and market dividing[63] because those cartels impede competition substantially and cannot provide consumers with any benefits as required by the exemption rule, they should be treated as per se illegal under the AML.

During the AML legislation process, several experts were concerned about the crisis cartel exemption set out in article 15(v) on the ground that such an exemption may give a green light to hardcore

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[62] *See* Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) at art. 81(3).

[63] For the per se rule, see ERNEST GELLHORN, WILLIAM E. KOVACIC & STEPHEN CALKINS, ANTITRUST LAW AND ECONOMICS, 200–243 (5th ed. 2004).

cartels. Previous German GWB had similar rules,[64] but in practice they were rarely relied upon.[65] In theory, economic recession is a business risk, and competition during the recession may facilitate the adjustment of market and product structure. Therefore, most countries do not grant competition law exemptions to crisis cartels. Because of the criteria set out in the AML,[66] one can expect that it would be difficult for crisis cartels to be exempted in practice.

Another concern is related to the exemption of export cartels implied by article 15(vi). Such an exemption may be based on two rationales. First, such cartels do not affect domestic competition.[67] Second, because Chinese undertakings often face antidumping actions from foreign countries, it may be necessary to allow the exporting companies to coordinate export prices in order to avoid the excessively low prices that might result from a price war between them, which might result in antidumping cases being undertaken by importing countries. Other countries have also similar exemptions. The United States, for example, granted antitrust exemptions to exporting cartels in the Webb-Pomerene Act of 1918[68] and the Export Trading Act of 1982.[69] What China could learn from the U.S. experience is to further clarify the criteria for anti-monopoly exemption of exporting cartels. However, because most jurisdictions deal with antitrust extraterritoriality in one way or another, the exporting cartel exemption in practice might provide little help to already troubled Chinese exporters. For example, a group of Chinese vitamin C producers were alleged to collectively control the price of vitamin C in the United States and other regions of the world and faced antitrust litigation in a federal court in Brooklyn, New York, in Janu-

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[64] *See* Act against Restraints on Competition GWB, chap. I § 6 (1998).

[65] *See* David B. Audretsch, *Legalized Cartels in West Germany*, 34 Antitrust Bull. 579, 580–82 (1989).

[66] *See* AML, art. 15, ¶ 2.

[67] According to article 2 of the AML, the law is to safeguard competition in the domestic market of the People's Republic of China.

[68] 15 U.S.C. §§ 61–65 (2000).

[69] 15 U.S.C. §§ 4001–4003, 4011–4021 (2000).

ary 2005.[70] In this case, Chinese exporters may be caught between the Scylla of antidumping investigations and the Charybdis of an antitrust prosecution, so being damned by antitrust rules if they coordinate uniform higher import prices and damned by being the target of an antidumping investigation if they don't.

The AML does not provide a mechanism for allowing undertakings to seek a monopoly agreement exemption. In the 2004 AML draft submitted by MOFCOM to the State Council, undertakings were obliged to notify the agreements to the anti-monopoly enforcement authority in order to obtain exemptions.[71] In the 2005 AML draft reviewed by the Legal Affairs Office of the State Council, the rule was revised to require only voluntary notification.[72] Apparently, the Chinese legislators learned from previous EC and Germen experience.[73] However, the notification and exemption approach is expected to impose a heavy work load on the AMEA and may leave the authority insufficient resources to deal with more serious cases. The AML system will eventually need to abandon the notification mechanism and choose the model of EC Regulation 1/2003.[74] In this model, an agreement would be automatically exempted if it met the criteria set forth in article 15 of the AML. However, the self-assessment required by article 15 would create difficulties and uncertainty for undertakings and their legal advisors.

According to the second paragraph of article 13, monopoly agreements in the AML refer to "agreements, decisions, or other concerted

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[70] *See* Brenda Sandburg, *Culture Shock: Chinese Companies are Learning Some Painful Lessons about the American Way of Litigation*, LITIGATION 2006, *available at* http://sidley.com/db30/cgi-bin/pubs/Litigation%202006%20-%20Culture%20Shock.pdf.

[71] MOFCOM, AML Draft Submitted to the Legislative Affairs Office of the State Council, arts. 12–15 (July 2004) (unpublished) (on file with author).

[72] *See* Legislative Affairs Office of the State Council, AML Draft (July 27, 2005) (unpublished) (on file with author).

[73] *See* Act against Restraints on Competition, GWB, chap. I §§ 9–10 (1998); Council Regulation 17, Implementing Article 85 and 86 1999 O.J. (L 148) 5. Articles 85 and 86 were superseded by current articles 81 and 82.

[74] Council Regulation 1/2003, Implementation of the Rules Laid Down in Article 81 and 82 of the Treaty, 2003 O.J. (L1/1).

behavior that eliminate or restrict competition."[75] According to article 16, industry associations are specifically prohibited from organizing undertakings to engage in monopoly agreements.[76] This provision was a late amendment during the AML third review by the Standing Committee of the 10th NPC in August 2007, which was the outcome of public outrage at a widely reported collective price increase by instant noodle producers. The price increase was initiated and organized by Instant Noodle China Association from the end of 2006 through early July 2007.[77] Many members of the Standing Committee of the 10th NPC expressed their concerns and requested that the AML explicitly prohibit industry associations from undertaking anticompetitive conduct.

Under article 46 of the AML, monopoly agreements that do not meet the criteria for exemption may lead to investigation and penalties by the AMEA. Remedies for the violation include an order to cease and desist from undertaking the conduct, confiscation of illegal gains, and a fine ranging from one to ten percent of previous annual turnover.[78] When a monopoly agreement is not put into effect, a fine of up to RMB 500,000 can be imposed.[79] For industry associations orchestrating or encouraging undertakings to reach a monopoly agreement, the AMEA may impose a fine of up to RMB 500,000[80]; in serious cases, the registration of the industry association may be revoked.[81] Furthermore, article 46 of the AML provides that if undertakings involved in monopoly agreements report, on their own initiative, information concerning the conclusion of monopoly agreements and provide important evidence to the AMEA, they may be given a mitigated punishment or be exempted from punishment

[75] This definition is similar to that found in the Act against Restraints on Competition, GWB, chap. VII § 37(1) (4).

[76] *See* AML, art. 16.

[77] *See* NDRC, *supra* note 39.

[78] *See* AML, art. 46.

[79] *Id*.

[80] *Id*.

[81] *Id*.

altogether.[82] This rule indicates that a cartel leniency policy has been transplanted into the AML. However, detailed implementing regulations or guidelines are needed in order to provide legal certainty of the application of reduced penalties.

In addition, according to article 50 of the AML, offenders are also liable to pay damages to injured parties. Moreover, the draft submitted by State Council to the Standing Committee of the 10th NPC provided that, when undertakings implement monopolistic conduct that constitutes criminal conduct, they should be subject to criminal liability in accordance with the laws.[83] However, this provision was eventually removed, making the AML out of step with the global competition law trend to extend criminal liability. Nevertheless, under article 223 of the Criminal Law of PR China, bid rigging is a criminal offense which could be punished by up to three-year's imprisonment. One may predict that, since bidding rigging is comparable to a hardcore cartel, criminal punishment might be introduced into the AML through future amendment.

V. VERTICAL RESTRICTIVE AGREEMENTS

With respect to vertical agreements, the AML prohibits only (i) fixing resale prices; (ii) restricting minimum resale prices; and (iii) other monopoly agreements to be determined by the AMEA.[84] Resale price maintenance is a popular restriction imposed by suppliers in China. Therefore, these provisions are influential in Chinese economic life.

Obviously, vertical agreements in the AML are treated differently from horizontal agreements; for example, vertical agreements restricting output or dividing markets are not prohibited. This means that Chinese lawmakers accepted the economic thinking that, compared with horizontal agreements concluded between competitors, most vertical agreements are procompetitive because they are concluded not between competitors, but between undertakings operating at different levels of the production/distribution chain.

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82 *Id*.

83 *See* AML Draft, *supra* note 18, at art. 49.

84 *See* AML, art. 14.

Vertical agreements, therefore, are not intrinsically restrictive; they can improve economic efficiency in production or distribution, thus increasing consumer welfare.

Nevertheless, vertical arrangements are not always positive to competition and economy. If a vertical arrangement is able to create or increase a dominant market position, it can become an exclusionary tool and so play a negative role in market competition. What kind of role a vertical arrangement plays in market competition depends to a great extent on the market position of the undertakings concerned.[85]

The provisions on vertical agreements in the AML are too general, lacking in consideration of the market position of the undertakings. The provisions are also devoid of any logical relationship with the provisions on abuse of dominant market position. It would be necessary for the AMC and the AMEA, based on their domestic experience and in view of the global trend, to promulgate detailed rules or relevant guidelines such as the regulation on vertical agreements in EC competition law.[86] In short, the AMEA needs to harmonize the approaches in these two antirust areas.

Finally, it should be emphasized that no per se rule is incorporated into the rule on vertical agreements in the AML, because the exemption provision in article 15 is also applicable to the vertical agreements proscribed in article 14. Addressing this issue, the Supreme Court of the United States in 2007 overturned its previous decision in *Dr. Miles*[87] and now holds that courts must determine the lawfulness of the minimum resale price maintenance by applying, not a bright line per se rule, but a circumstance-specific rule of reason.[88]

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85 *See* Commission Regulation 2790/1999, Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practice, 1999 O.J. (L 336) 21.

86 *Id*.

87 Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373, 394, 408–09 (1911) (holding that an agreement between a manufacturer of proprietary medicines and its dealers to fix the minimum price at which its medicines could be sold was "invalid . . . under the [Sherman Act, 15 U.S.C. §1]").

88 Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2720 (2007).

This decision is expected to become influential in other regimes including China's.

VI. CONCENTRATIONS OF UNDERTAKINGS

Undertakings engage in concentrations (mergers and acquisitions) as a strategy to acquire managerial and technical talent, attain economies of scale and scope, and to improve their efficiencies and competitiveness. At the same time, undertakings have a natural inclination to increase their market shares with the objective of attaining market power. Unfettered concentration of undertakings, then, can affect market competition, eliminate competitors, and create a monopolistic market structure. Control of concentration, therefore, constitutes an important part of the AML.

A. The concept of concentrations of undertakings

In the AML, the concept of "concentrations of undertakings" refers to a variety of situations, including (i) mergers, (ii) acquisitions of control of other undertakings through the purchase of shares or assets, and (iii) acquisitions of control of other undertakings, or of the ability to exercise decisive influence over other undertakings, through contract or other means.[89] Treatment of joint ventures under the AML presents legal and economic analytical challenges and therefore is a question that requires further clarification. In order to secure effective competition, control of concentrations of undertakings should cover restructuring activities that could directly or indirectly result in decisive influence on other undertakings. Therefore, EC Regulation 139/2004 defines a "concentration" as a situation where a change of control on a lasting basis results from a merger, an acquisition, or the creation of a joint venture performing all the functions of an autonomous economic entity.[90]

B. Notification

According to the AML, a prior notification should be filed with the AMEA by undertakings of a concentration if the notification thresh-

[89] *See* AML, art. 20.

[90] *See* Comm'n Regulation 139/2004, Control of Concentrations between Undertakings, 2004 O.J. (L24/1) art. 3(4) [hereinafter EC Merger Regulation].

olds stipulated by the State Council are met.[91] The AML provides exceptions to the notification obligations where: (i) one of the undertakings already holds more than fifty percent of the voting rights or the assets of all other undertakings concerned in the concentration; or (ii) an undertaking not involved in the concentration holds more than fifty percent of the voting rights or assets of all other undertakings concerned in the concentration.[92] Restructuring activities among undertakings belonging to the same corporate group will not cause a significant change in market structure. Therefore, they are exempted from the notification obligation of the AML merger control rules.

The AML does not provide specific notification thresholds, leaving the task of future clarification to the State Council. This omission was due to heated debates and divergent opinions towards the previous proposed turnover thresholds during the first deliberation of the AML in June 2006. Under the June 2006 AML Draft, a prior notification would have been required to be filed with the AMEA by undertakings of the concentration if (i) the combined aggregate worldwide turnover of all the undertakings concerned in the preceding year exceeded RMB 12 billion and (ii) the aggregate nationwide turnover in the preceding year of any one undertaking concerned exceeded RMB 800 million.[93] During the June 2006 deliberation, some members of the 10th Standing Committee of the NPC believed the thresholds were too low while others argued that the thresholds should not be too high. Some suggested that the thresholds should include turnover as well as market share while others suggested sector-specific notification thresholds.[94] Outside the Standing Committee of the NPC, leading practitioners and scholars had suggested that, in order to exclude notification of concentrations having either a very limited nexus with China or the effects of which were indirect, remote, and unpredictable to the Chinese market, the AML should require that at least two undertakings, as opposed to only one, should have a China-wide turnover meeting the thresholds.[95]

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[91] *See* AML, art. 21.

[92] *See id.* at art. 22.

[93] AML Draft, *supra* note 18, at art. 17.

[94] Law Committee to the 10th NPC, Report on Revisions of AML Draft of the P.R.C. (Draft), (10th Standing Comm. of the NPC Doc. No. 4).

Considering these different opinions among interested parties and the need to adjust the notification thresholds according to economic developments, the Law Committee of the 10th NPC suggested that the State Council stipulate and adjust the thresholds.

As the first step towards implementing the AML, the State Council promulgated the *Provisions on Thresholds for Prior Notifications of Concentration of Undertakings* on August 3, 2008.[96] Under these provisions, a transaction must be prenotified to MOFCOM when either of the following thresholds is met: (i) the total and aggregate global sales revenue (turnover) in the previous accounting year of all of the undertakings to the concentration transaction exceeds RMB 10 billion (US$1.458 billion), of which at least two undertakings to the transaction each had sales revenue from sales within China from the previous accounting year exceeding RMB 400 million (US$58.34 million)[97]; or (ii) all of the undertakings to the concentration transaction have a total and aggregate sales revenue exceeding RMB 2 billion (US$291.6 million) from within China for the previous accounting year, of which at least two undertakings to the transaction each had sales revenue from sales within China from the previous accounting year of more than RMB 400 million (US$58.34 million).[98] Additionally, for those concentrations of undertakings which do not reach any of the thresholds above but which the AMEA deems may have the effect of eliminating or limiting competition in the relevant market, the AMEA may require such undertakings to file a notification in accordance with these provisions.[99]

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[95] *See* Joint Submission of the American Bar Association's Sections of Antitrust Law, Intellectual Property Law and International Law on the Proposed Antimonopoly Law of the People's Republic of China 22 (2005). *See also* Wang Xiaoye, *Review of the Concentrations of Undertakings under the Chinese Anti-Monopoly Law Draft* (presented at the 5th International Symposium of Competition Law and Policy, China Academy of Social Sciences, May 11–12, 2007).

[96] *See* Provisions on Thresholds for Prior Notification of Concentrations of Undertakings (promulgated by the St. Council, Aug. 3, 2008, *available at* http://fldj.mofcom.gov.cn/aarticle/c/200903/20090306071501.html.

[97] *Id*. at art. 3.

[98] *Id*.

[99] *Id*. at art. 4.

It is noteworthy that, prior to the enactment of the AML, the 2003 Interim M&A Rules and now the M&A Rules provide relevant notification thresholds and request foreign investors to file their proposed mergers and acquisitions of domestic enterprises to MOFCOM and SAIC.[100] Following the enactment of the AML, the 2006 M&A Rules provisions of anti-monopoly review are expected to be superseded.[101]

C. A two-phase merger review

In order to ensure sufficient time for the AMEA to act and at same time to minimize the uncertainty of the transaction for the undertakings concerned, the timetable for merger review should be neither too short nor too long. Primarily based on the EC Merger Regulation model,[102] the AML provides for two phases, i.e., the preliminary review and further review, for the AMEA to carry out its concentration analysis.

First, concentrations that meet the notification thresholds stipulated by the State Council must be notified to the AMEA.[103] Such concentrations cannot be implemented either before notification or before the expiration of the preliminary review period of thirty days.[104] With a preliminary review following the notification, the AMEA may either make a decision to open a further review investigation or make a decision that no further investigation will be conducted.[105] If the AMEA fails to reach a decision within the time limit, the proposed concentration is deemed to be cleared.[106]

The time limit for the further review is ninety days, which can be extended by up to another sixty days in specified circumstances and

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100 *See supra* note 11 and accompanying text.

101 *See* http://news.163.com/09/0724/01/5EUTFMB00001124J.html (Chinese language version).

102 *See* EC Merger Regulation, *supra* note 90, at art. 10.

103 AML, art. 21. For documents required for the notification, see AML, art. 23.

104 *See id.* at art. 25.

105 *Id.*

106 *See id.*

with the AMEA's written notice to the undertakings involved.[107] These circumstances include (i) an agreement by the undertakings concerned to extend the time limit; (ii) documents submitted by the undertakings concerned are inaccurate or need further verification; or (iii) relevant circumstances have significantly changed following the notification.[108]

Compared with the ninety-day time limit provided by the M&A Rules,[109] the AML timetable for clearance of concentrations presents a significant improvement. Because the vast majority of notifiable concentrations are expected to impose nonsignificant impediments on market competition, a ninety-day period of anti-monopoly review is too long and may cause significant expense and troublesome delay to the undertakings concerned.

According to the information issued by MOFCOM,[110] there have been fifty-eight transactions notified during the time from the AML's effective date to the end of June 2009; forty-three transactions among them have been cleared, two subjected to remedies,[111] and one prohibited.[112] Despite the lack of detailed information, it seems that only a very few cases have been subject to further review under the AML.

D. Substantive appraisal test

According to the AML, the substantive appraisal test is based on whether a proposed concentration "has or may have the effect of

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107 *See id.* at art. 26.

108 *See id.* at art. 26.

109 *See supra* note 11 and accompanying text.

110 *See* MOFCOM, http://fldj.mofcom.gov.cn/aarticle/zcfb/200907/20090706409831.html (last visited Aug. 10, 2009).

111 See MOFCOM, Notice No. 95 (InBev) (Nov. 18, 2008), *available at* http://fldj.mofcom.gov.cn/aarticle/ztxx/200811/20081105899216.html (Chinese language version); MOFCOM Notice No. 28 (Apr. 24, 2009), *available at* http://fldj.mofcom.gov.cn/aarticle/ztxx/200904/20090406198805.html (Chinese language version).

112 See MOFCOM, Notice No. 22 (Decision to Prohibit Coca-Cola's Acquisition of Huiyuan Co.), *available at* http://fldj.mofcom .gov.cn/aarticle/ztxx/200903/20090306108494.html (Chinese language version).

eliminating or restricting competition."[113] This means the AMEA will decide whether to prohibit a proposed concentration in accordance with competition policy. In the examination of concentrations, the AMEA shall take into account the following factors: (i) the relevant market share and the ability to control the market(s) of undertakings concerned; (ii) the concentration degree in the relevant market; (iii) the effects on market entry and technology development; (iv) the effects on consumers and other related undertakings; (v) the effects on national economic development; and (6) other factors having an effect on market competition.[114]

Among the factors above, the market share, market power, and market concentration degree are significant. Market power is a particularly crucial factor because it is not only used to know whether a proposed concentration may eliminate or restrict competition, but it also indicates that one of the objectives of the AML in concentration regulation is to prevent the creation and strengthening of market power. Although the AML does not define the concept of market power, significant market power can be understood to be the ability to control price, product quantity or other trading conditions in the relevant market, or to restrict or affect market entries.[115]

It is notable that the AML also requests that the AMEA consider the "effects of the proposed concentration on national economic developments."[116] In theory, the factor of "national economic developments" should not be understood only from an industrial policy perspective. Excessive concentration may have the significant effects of eliminating or restricting competition and harming national economic development in the long run. In practice, however, law and policy

[113] *See* AML, art. 28.

[114] *See id.* at art. 27.

[115] *Compare* with AML, art. 18. According to article 17 of the AML, dominant market position means a market position in which an undertaking is capable of controlling the price or quantity of commodities or other trading conditions or preventing or affecting other undertakings' market access in the relevant market. The dominant market position here can be understood as market power.

[116] *See* AML, art. 27.

makers tend to overestimate the positive effect of concentration on industrial policy, while they tend to underestimate its negative effect on competition policy.[117] Therefore, as regards the question of how the "effects of the proposed concentration on national economic developments" will be applied in practice, one needs to wait for the decisions of the AMEA in the future.

E. Market definition

An assessment of market power or market-dominant position requires delineation of the relevant market. According to the AML, relevant market is understood as "the scope of products or of territory within which the undertakings compete with respect to specific products or services (collectively referred as "products") during a certain period of time."[118] This definition includes product market and geographic market as two basic elements of relevant market. This thinking is imprecise and even flawed. This definition does not clarify that one of the basic principles of market definition is demand substitution: whether or not products are substitutes for one another from a consumer's perspective.

Guidelines on the Definition of the Relevant Market were published on July 7, 2009, on behalf of the Antimonopoly Commission of the State Council at the website of MOFCOM.[119] The Guidelines emphasize the importance of scientifically and reasonably defining the relevant market and stating that in antitrust enforcement work market definition is the starting point and first step for analyzing a series of

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117 *Compare* with AML, art. 5. According to article 5 of the AML, undertakings may enter into concentrations, expand operating scale and enhance market competitiveness in accordance with law through fair competition and voluntary cooperation. The content of this article seems to be no problem, but it is not suitable to be placed in an anti-monopoly law, because anti-monopoly law should focus only on how to avoid excessive concentration and protect competition. The article demonstrates that the lawmakers paid more attention to industrial policy than competition policy.

118 *See* AML, art. 12, ¶ 2.

119 *See* MOFCOM, Guidelines on the Definition of the Relevant Market, http://fldj.mofcom.gov.cn/aarticle/j/200907/20090706384131.html (Chinese language version) [hereinafter Guidelines].

key issues, such as identifying competitors and potential competitors, determining market share or the market position of the business operators and degree of market concentration, analyzing the impact of anticompetitive conduct on market competition, and so on.[120]

The Guidelines set forth two aspects of the relevant market: product market and geographic market. Under the Guidelines, the basic method for defining the relevant market is substitution analysis, and the first consideration is demand substitution.[121] The Guidelines list a number of factors—none of them decisive—that may be considered when defining the relevant product market and relevant geographic market, in particular from the perspective of demand substitution.[122]

Based on the experiences of U.S. and EU antitrust law and enforcement,[123] the Guidelines also introduce the hypothetical monopolist test (HMT), which is also known as the Small but Significant and Non-Transitory Increase in Price (SSNIP) test, to assist the AMEA in determining the relevant market. Under the SSNIP test, the relevant product market and relevant geographic market will be expanded to additional products and geographic areas if the relevant customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range five to ten percent) and permanent (usually about one year) relative price increase in the products and areas being considered. If substitution would be enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market.[124]

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[120] *See id*. at art. 2.

[121] *See id.* at art. 7.

[122] *See id.* at arts. 8 & 9.

[123] The SSNIP test was first adopted by the U.S. Department of Justice in the 1982 Horizontal Merger Guidelines, http://www.usdoj.gov/atr/hmerger/11248.htm, and it was introduced into Commission Notice on the Definition of the Relevant Market for the Purpose of Community Competition Law, 1997 O.J. (C 372).

[124] *See* Guidelines, *supra* note 119, at art. 10.

The Guidelines seem to indicate an improvement in terms of the transparency and objectivity in enforcement of AML. The Guidelines urge business operators to gather objective proof and use economic analyses to determine the relevant market.[125] But knowing whether and how the AMEA will use such proof to undertake economic analyses in determining the relevant market will have to wait for concrete cases in the future.

F. Merger defenses

According to the AML, during the course of the further review, if the AMEA reaches a conclusion that the proposed concentration may eliminate or restrict competition, the AMEA shall adopt a decision prohibiting the concentration.[126] However, the AMEA may decide not to prohibit the proposed concentration if the involved undertakings can prove either that the advantages of implementing the concentration exceed the disadvantages or that the concentration is in harmony with the public interest.[127] Furthermore, if the AMEA decides to approve a concentration, it may impose "restrictive conditions" on the implementation of the concentration in order to "reduce the negative effects arising from the proposed concentration."[128]

These AML provisions provide two concentration defenses, both of which are based on German experience.[129] The first is that the advantages of implementing the concentration exceed the disadvantages. The second is that the concentration is in harmony with the public interest. For example, clearance may be granted if the merged party is a failing firm, which would be forced out of the market without the proposed concentration. In this case, if the parties can demonstrate that the merger will result in an improvement of market

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[125] *See id.* at art. 7.

[126] *See* AML, art. 28.

[127] *Id*.

[128] *See* AML, art. 29.

[129] *See* Gesetz gegen Wettbewerbsbeschränkungen, GWB [Act Against Restraints on Competition], Aug. 28, 1998, at chap. VII §§ 36(1) & 42(1), *available at* http://www iuscomp.org/gla/statutes/GWB.htm.

conditions that outweighs the disadvantage of the market dominance resulting from the merger.

Efficiency arguments have not directly been recognized as concentration defense. However, since the AML requests that the AMEA consider the proposed concentration's effects on national economic development,[130] a notified transaction may be cleared based on efficiency claims, e.g., increasing the competitiveness of industry and rationalizing production.

As regards the public interest defense, the M&A Rules may provide reference to a certain extent. The M&A Rules provide that parties may apply for an exemption from anti-monopoly review if the proposed transaction can (i) improve conditions for fair competition; (ii) restructure loss-making enterprises and safeguard employment; (iii) introduce advanced technologies and management talent and improve the enterprise's international competitiveness; or (iv) improve the environment.[131] The last three situations can be seen as for the purpose of the public interest. The provision on public interest may be necessary because the implied flexibility leaves discretion to the AMEA in balancing competition policy and other values. However, it would be a real challenge for the AMEA to deal with competition policy and industrial policy simultaneously.[132]

For the sake of legal certainty, detailed guidance is urgently needed on control of concentrations of undertakings, because supporting and developing "national champions" to compete globally has been a much emphasized economic policy in China, and the AML also reflects this policy priority in many respects.[133] Moreover, it was declared by the State Assets Supervision and Administration Commission (SASAC) that the state-owned economy should maintain absolute control in the key industries that are crucial to national secu-

130 *See* AML, art. 27.

131 *See* M&A Rules, *supra* note 11, at art. 56.

132 In German law, the decision based on public interest is at the discretion of the economic minister, but not in the hands of the Federal Cartel Office. *See* Act Against Restraints on Competition, chap. VII § 42(1).

133 *See* AML, arts. 4, 5 & 7.

rity and the national economy.[134] The SASAC clearly identified seven industries that should be dominated by SOEs, including the defense industry, the electricity grid and electricity production and supply, the petroleum and petrochemical industry, coal, civil aviation, and shipping.[135] The objectives are to increase the total value of state-owned assets and to improve enterprise structures and efficiencies. The SASAC stated that the state will foster key SOEs in order to develop them into national champions and, by the year 2010, China will have thirty to fifty big enterprise groups with global competitiveness.[136] Following this policy statement, the exemption from the AML of natural monopolies and other industries controlled by the state-owned economy has been promoted by the SASAC and big SOEs such as the State Grid Corporation of China.[137] However, most Chinese people do not believe that the protection supplied by the state and government is able to increase the international competitiveness of the national champions. China's practice has already proved that most economic and administrative monopolies are irrational in essence because they restrict output, distort price and waste resources. Monopolies can harm consumer welfare in the short run, and cause inefficiency, weaken the national economy, discourage competitive spirit in the long run, and therefore deprive the country of much needed real energy for development.

VII. ABUSE OF DOMINANT MARKET POSITION

Undertakings are able to acquire dominant market position through various routes, such as state authorization, cutting-edge innovation, or superb management. The AML does not prohibit lawful acquisition of a dominant, even monopolistic position. However, market power held by dominant undertakings shields their market behavior against constraints from competitors or the competition

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[134] Zhang Yuzhe, *The Anti-monopoly Legislation Cannot Resolve the Dilemma of Natural Monopolies*, CAIJING.COM.CN, Chinese version *available at* http://www.caijing.com.cn/2007-08-23/100027944.html.

[135] *Id.*

[136] *Id.*

[137] *Id.*

mechanism. Therefore, the AML prohibits undertakings with a dominant position from engaging in abusive behavior that impedes competition and harms consumer welfare.

A. Conduct in abuse of dominant market position

The AML prohibits dominant undertakings from abusing their position to restrict or eliminate competition.[138] The AML provides an illustrative, but nonexhaustive, list of prohibited abusive behavior, including, without valid justification, selling or buying goods at unfairly high or low prices, below-cost sales, refusals to deal, exclusive or forced dealing, tying or imposing other unreasonable transactional terms, and discriminatory dealing.[139] Other abusive behavior by undertakings holding a dominant position determined by the AMEA is also prohibited.[140] The specifically prohibited practices listed above can be classified as either exploitive or exclusionary conduct.

B. Defining dominant market position

The term "dominant market position" means a market position that enables an undertaking to control price, quantity of product or other trading conditions in the relevant market, or to block or affect other undertakings in entering relevant markets.[141] This definition is very similar to the concept of a dominant position in EC competition law,[142] as well as the concept of market power in U.S. antitrust law.[143] As the premise for determining market dominance, the AML formulates the relevant market as an area or a scope within which the undertakings compete against each other during a certain period of time for relevant commodities or services.[144]

[138] AML, art. 17.

[139] *Id.* at art. 17 (i) - (vi).

[140] *Id.* at art. 17 (vii).

[141] *Id.* at art. 17.

[142] Case 72/21 Continental Can Co., 1972 J.O. L 7/25.

[143] *See*, *e.g.*, Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1060 (8th Cir. 2000); Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1353 (Fed. Cir. 1999); United States v. Grinnell Corp., 384 U.S. 563, 571 (1966).

[144] AML, art. 12, ¶ 2.

In order to make this definition workable, the AML further specifies a nonexhaustive list of illustrative factors for verifying the existence of a dominant market position: (i) the market share of the undertakings and their competitive status in the relevant market; (ii) the ability to control the upstream or downstream market; (iii) the financial status or technical resources of the undertakings; (iv) the extent of dependence on the undertakings by other undertakings; (v) the accessibility of entry by other undertakings into the relevant market; and (vi) other factors relating to the dominant market position of the undertaking.[145]

In view of the fact that the market structure plays a key role in influencing the market behavior of undertakings,[146] the AML contains three presumptions of the market dominant position of undertakings, based entirely on the market share thresholds. It provides that the undertakings can be considered to have a dominant market position if any of the following conditions is fulfilled: (i) the market share of one undertaking is fifty percent or more; (ii) the combined market share of two undertakings accounts for two-thirds or more; (iii) the combined market share of three undertakings accounts for three-fourths or more.[147] If the combined undertakings fall under conditions (ii) or (iii), any undertaking that has a market share of less than ten percent shall not be considered to have dominant market position.[148] The source of these presumptions obviously can be traced to the German Act Against Restraints of Competition.[149]

As is the case under the German act, these presumptions are rebuttable.[150] For example, if the undertaking can demonstrate that the relevant market remains substantially competitive, or the undertak-

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[145] *See id.* at art.18.

[146] *See* Case 85/76, Hoffmann-La Roche, 1979 E.C.R. 461.

[147] *See* AML, art. 19.

[148] *Id*.

[149] For instance, according to section 19(3) of the German Act Against Restraints of Competition, a market share of one-third is sufficient to establish a presumption of dominance Gesetz gegen Wettbewerbsbeschränkungen, GWB [Act Against Restraints on Competition], Aug. 28, 1998.

[150] *See id*.

ings under consideration have no dominant position in relation to the remaining competitors, such undertaking or undertakings should not be deemed to have a dominant position.[151] Therefore, the market share presumption in the AML functions as a trigger to warn undertakings and to remind the AMEA that a market-dominant position is more likely to be present when market shares reach certain levels. Consequently, the undertakings involved should have the right to rebut such presumptions. In reality, a market economy can be volatile; therefore, an excessively rigid rule for determining dominant position may not be flexible enough to reflect the competitive market place or to identify every instance of abuse of dominance.[152]

C. Legal liabilities of abusive behavior

Remedies for the infringement of rules on abuse of dominant position include orders to cease and desist from the objectionable conduct, confiscation of illegal gains, and fines of between one and ten percent of previous annual turnover.[153] As is the case with the rule against monopolistic agreements, when imposing administrative fines the AMEA shall take into account factors such as the nature, extent and duration of the alleged abusive behavior.[154] This provision requires the AMEA to impose sanctions based on careful consideration of all relevant factors.

VIII. CONCLUSION

The AML should be seen as an influential law on China's economic development. Focusing on undertakings' competitive behavior in the marketplace, the AML directly affects business operators in China. The AML is also expected to improve consumer and social welfare because market competition delivers lower prices, higher quality and more choice for consumers. Furthermore, the AML, by

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[151] *See* AML, art. 19, ¶ 3.

[152] Several courts in the United States have allowed evidence of direct effects to substitute for strict market share thresholds. *See*, *e.g.*, Toys "R" Us, Inc. v. FTC, 221 F.3d 928, 937 (7th Cir. 2000).

[153] *See* AML, art. 47.

[154] *See id.* at art. 49.

indicating the legislators' determination to fight against administrative monopoly, will affect governmental agencies at all levels. The AML, therefore, increases government officials' anti-monopoly awareness and promotes the establishment and development of a competition culture in China.

Nonetheless, due to the incomplete economic transition and certain imperfect aspects of the AML, one can predict challenges in enforcing the AML, in particular, at the early implementation stage: e.g., the lack of an independent and unified enforcement agency, widespread administrative monopoly, and undertakings' rent-seeking behaviors. Powerful sector-specific regulators may seriously challenge the AML's effectiveness and authority. Moreover, the AML has only fifty-seven articles, most of which lack specificity and enforceable rules. Nevertheless, the AMC and the AMEA are expected to promulgate implementing regulations and interpreting guidelines very soon. The enactment of the AML, then, is just the beginning of Chinese anti-monopoly legislation, not to be taken as the finishing touch to such a prolonged, conflict-driven and interest-oriented process.

Competition law and policy of the Republic of Korea

BY MEONG-CHO YANG*

I. INTRODUCTION

A. History of antitrust legislation in Korea[1]

Early in 1964, the Korean Economic Planning Board (EPB, now defunct) formulated a draft of the Fair Trade Law and held a public hearing on it but was frustrated in going ahead because of the strong opposition in business circles. Afterwards, several pieces of antitrust legislation were submitted to the National Assembly by the Executive. Those bills, however, were abandoned due either to the termination of the Assembly session or the dissolution of the National Assembly.

To curb the soaring prices of commodities, the EPB studied price control schemes in 1975. The Price Stabilization and Fair Trade Act (PSFT Act) was enacted in late 1975. It was aimed prima-

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[1] For a more detailed discussion of Korea's early attempts to introduce competition law, see Youngjin Jung & Seungwha Chang, *Korea's Competition Law and Policies in Perspective*, 26 NW. J. INT'L L. & BUS. 687, 688–94 (2006).

rily at price restraints, while the prohibitions against cartels and unfair business practices were secondary means for limiting excessive prices.

Though the PSFT Act had provisions against cartels, only three cartel cases were challenged by the authorities from 1976 through 1979. Thus, even after the promulgation of the PSFT Act, the government did not show an active attitude toward regulating cartels. Rather, it approved several rationalization or depression cartels. Under the permission or patronage of the government, more than 250 trade associations were newly organized during that period and operated actively. Emphasizing short term price stabilization, the PSFT Act did not reach market structure; rather, it regulated nothing but market behavior. It was primarily a price control law, and cartel regulation was to be utilized as a means of short term price stabilization.

In the latter half of the 1970s, it was realized that ever-increasing business concentration had resulted in reduced competitiveness of domestic enterprises in world markets and imbalance in the national economy. In 1979, eighty-nine percent of the industrial goods produced in Korea were manufactured by monopolists or oligopolists; only eleven percent of the industrial goods were manufactured under competitive conditions.[2]

The Constitution of the Fifth Republic includes an antitrust provision which states: "Abuses of monopoly or oligopoly shall be appropriately regulated and adjusted."[3] In September 1980, the government made public a plan to enact the Monopoly Regulation and Fair Trade Law before the end of the year, which purported to regulate monopolies and restore functioning markets and then to convert the basis of the national economy from the system of direct control through administrative patronage or subsidization to a more competitive system of private initiatives. The government also proclaimed its plan to abolish various kinds of special economic laws and regulations that had hindered competition among industries.

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[2] Economic Planning Board, National Economy White Paper 81, 100–01 (1998) (on file with author).

[3] Constitution of the Republic of Korea, No. 9 of 1980, art. 120, ¶ 3.

Administrative officials studied the relevant legislation of leading countries with consideration to the economic situation of Korea and made a draft. The Monopoly Regulation and Fair Trade Act (MRFT Act) was passed by the Legislative Council on December 23, 1980.[4] The MRFT Act was promulgated by the President on December 31, 1980, and came into force on April 1, 1981. It was extensively revised in December 1986, in January 1990, in December 1994, in December 1996, in December 1999, in December 2004, and in April and July of 2007.[5]

B. *Future emphasis of competition law enforcement*

Several points should be noted with regard to the enforcement of the MRFT Act in the coming years. The current antitrust legislation accepts the existence of monopolies and oligopolies but tries to correct abuses of market power. Some apparently abusive acts had previously been overlooked on the basis that they were longstanding business practices, even though such practices would not have been acceptable in a competitive market. The MRFT Act now has a programmatic provision declaring its aim to move toward the divestiture of monopolies.[6] Quite recently the government declared that it would enforce the law more vigorously against market-dominant enterprises.

To achieve the efficient enforcement of the antitrust law, the expansion of the leniency program and invigoration of private enforcement have been emphasized. Most large enterprises are very well aware of the benefit of the new leniency procedures implemented by the Korean antitrust authority, the Fair Trade Commission (KFTC).[7] Nevertheless, clear differences of opinion exist between the business community and the authorities. Leniency applicants contend that full disclosure of attainable evidence should suffice to obtain exemption from penalties. On the other hand, the authorities view a

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[4] Monopoly Regulation and Fair Trade Act, Law No. 3320 of 1980.

[5] For revisions of the MRFT Act, see http://eng.ftc.go.kr/files/bbs/2008/MARFTA.rtf.

[6] *Id.* at art. 3.

[7] For general information about the KFTC, see http://eng.ftc.go.kr/about/overview.jsp. (last visited July 28, 2009).

leniency application as if it were a guilty plea or confession of the crime. The KFTC officials are not sympathetic to a respondent's contention about the illegality of its alleged antitrust violation after its submission of leniency application.

A better balance of administrative enforcement and private enforcement would be ideal. The antitrust legislation and the KFTC have invented a variety of methods to boost private damage actions. Punitive damages or treble damages have been suggested in academia. However, their effectiveness is limited by the victims' incentives. Efficient judicial proceedings have to be established in order to energize private remedial actions. Finally, the KFTC routinely stretches the MRFT Act overseas to pursue and regulate anticompetitive behavior by foreign companies located in foreign jurisdictions. Global cartel enforcement is probably the most glaring example of this trend.[8]

II. OBJECTIVE OF COMPETITION LAW AND AGENCY DESIGN

A. Objective of the MRFT Act

Unlike the competition laws of other jurisdictions, the MRFT Act has an article declaring its legislative purpose.[9] This article emphasizes three objectives: (i) to encourage creative business activities; (ii) to protect consumers; and (iii) to strive for balanced development of the national economy. To achieve these objectives, the Act presents its purpose as promoting fair and free competition and provides specific tools for the promotion of competition: preventing abuse of market-dominant position; preventing excessive concentration of economic power; regulating improper concerted acts; and regulating unfair business practices.

The MRFT Act's three objectives indicate that its purpose is not limited to consumer welfare. The objective of encouraging creative

[8] *See* Julian M. Joshua, Peter D. Camesasca & Youngjin Jung, *Extradition and Mutual Legal Assistance Treaties: Cartel Enforcement's Global Reach*, 75 ANTITRUST L.J. 353 (2008).

[9] MRFT Act, art. 1.

business activities is understood to include innovation in production or service markets that leads to enhancement of efficiency and finally to consumer welfare. The third objective of the Act, the balanced development of the national economy, could be misconstrued as mere rhetoric. However, it reveals that consumer welfare may not always be the paramount goal of this legislation and that the national interest could outweigh consumer welfare in some situations.

In Korea, harmonized growth among geographic regions is highly stressed and boosting or supporting small businesses is one of the top priority issues to be addressed by the administration. Global competitiveness is another national interest that might compromise a pure consumer welfare objective in some instances.

B. The Korea Fair Trade Commission

1. CHANGES OF ENFORCEMENT AGENCY Although the courts may participate in antitrust enforcement in private antitrust actions and through review of the administrative decisions, the KFTC is mainly responsible for undertaking investigations and taking corrective measures in respect of antitrust violations. Before the 1990 amendment of the MRFT Act, the KFTC was an advisory body to the Minister of the EPB (EPB Minister), and the EPB Minister assumed the ultimate responsibility for administrative antitrust enforcement. The 1990 amendment transferred antitrust jurisdiction from the EPB Minister to the KFTC, but the KFTC still remained within the EPB and the EPB Minister controlled the budget and personnel management of the KFTC. Soon after, the EPB was abolished through an agency restructuring. Under the 1994 amendment of the MRFT Act, the KFTC became a regulatory agency under the jurisdiction of the Prime Minister,[10] independent from governmental economic or planning ministries.

2. THE KFTC The KFTC is responsible for the administrative enforcement of the MRFT Act, the Fair Subcontract Transactions Act,[11]

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10 *Id.* at art. 35.

11 English translation is available by subscription at http://elaw.klri.re.kr/indexE.jsp.

and the Adhesion Contract Regulation Act.[12] Fair Labeling and the Advertising Act and the Fair Franchise Act are also under the jurisdiction of the KFTC. The KFTC consists of nine commissioners: the chairman, the vice chairman, three full-time standing commissioners, and four nonstanding commissioners. The chairman and the vice chairman are appointed by the President upon the recommendation of the Prime Minister, while the other commissioners are appointed by the President upon the recommendation of the KFTC chairman. The KFTC chairmanship is at the level of a minister. The three full-time standing commissioners are government officials who have antitrust background; the four nonstanding commissioners are law or economics professors or attorneys.

Article 36 of the MRFT Act provides that the following matters are under the jurisdiction of the KFTC:

1. prohibition of the abuse of a market-dominant position;
2. restricting anticompetitive mergers and preventing the concentration of economic power;
3. prohibition of improper concerted acts;
4. regulation of unfair business practices and resale price maintenance;
5. prevention of unfair international contracts;
6. policies to promote competition with respect to legislative and administrative measures; and
7. matters designated by other laws and regulations to be handled by the KFTC.

The chairman is the executive and administrative head of the KFTC. He convenes and presides over KFTC meetings and is entitled to attend and speak at the State Council. The term of office for all the commissioners is three years and may be renewed only once. Any KFTC decision shall be made by a majority vote and shall be made in a written form signed and sealed by the commissioners who participate in the decisionmaking.

[12] English translation is available by subscription at http://elaw.klri.re.kr/indexE/jsp.

Meetings of the KFTC take place in the form of a full committee meeting or a subcommittee meeting. The full committee meeting is presided over by the chairman with the participation of all nine commissioners. The full committee decides important cases and deliberates on matters such as the enactment, revision, modification, or interpretation of the laws, decrees, and notifications relating to fair trade. It also makes decisions on cases against which objections have been filed.[13] Decisions at the full committee meeting require concurrence of a majority of the members.[14]

Subcommittee meetings are composed of at least one standing commissioner and two standing or nonstanding commissioners, and its meetings are presided over by the standing commissioner. The subcommittees deliberate and decide on those ordinary or less important cases or matters which are not under the jurisdiction of the full committee. Decisions by a subcommittee require the unanimous consent of all the members.[15]

3. THE SECRETARIAT OF THE KFTC The Secretariat deals with all the matters under the jurisdiction of the KFTC. The head of the Secretariat is Secretary General and the Secretariat is composed of seven bureaus, the Litigation Team and the Office of General Counsel. The seven bureaus are: (1) Planning and Public Relations Bureau; (2) Competition Policy Bureau; (3) Consumer Policy Bureau; (4) Market Supervision Bureau; (5) Market Analysis Bureau; (6) Cartel Bureau; and (7) Business Cooperation Bureau. Currently five regional offices are established in major cities in Korea

C. Role of courts in competition law enforcement

Antitrust cases are decided by the courts in the following five situations: (i) where a lawsuit to quash the KFTC's corrective order or surcharge is brought by the respondent in the administrative procedure[16]; (ii) where an action to nullify an unlawful merger or incorpo-

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13 MRFT Act, art. 37-3, ¶ 1.

14 *Id.* at art. 42, ¶ 1.

15 *Id.* at art. 42, ¶ 2.

16 *Id.* at art. 54.

ration is brought by the KFTC[17]; (iii) where a damages action is brought by a person injured by the act of an enterprise in violation of the MRFT Act[18]; (iv) where the validity of a cartel agreement is challenged by one or more participants thereof[19]; or (v) where an antitrust violation is prosecuted according to the penal provisions of the MRFT Act.[20]

D. Damages action

As Koreans in general are not litigious, a vigorous private litigation in the antitrust area is rare. The alleged victim of an antitrust violation has two ways to recover damages. An action under the Korean Civil Code[21] may be maintained as well as proceedings under the MRFT Act. In choosing action under the civil code, the litigant has to gather evidence concerning the violator's negligence in addition to proving the amount of the incurred damage.

The authorities have tried to increase the number of private antitrust actions by providing several incentives to plaintiffs for filing damages suits according to the legal procedures of the MRFT Act. Such incentives include (i) reversal of the burden of proof in that the defendant must show the absence of negligence rather than the plaintiff having to prove it[22]; (ii) the court itself may estimate the reasonable amount of damage without the plaintiff's proof[23]; and (iii) the court has the power to refer to the KFTC's case records.[24] However, a KFTC finding against a violator of the MRFT Act is not a prerequisite for a private damages action.

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17 *Id.* at art. 16, ¶ 2.

18 *Id.* at art. 56. Under current law only actual damages can be claimed.

19 *Id.* at art. 19, ¶ 4.

20 *Id.* at arts. 66–69.

21 The Korea Civil Code, Law No. 8720 of 2007, art. 750. English translation available by subscription at http://elaw.klri.re.kr/indexE.jps.

22 MRFT Act art. 56, ¶ 1.

23 *Id.* at art. 57.

24 *Id.* at art. 56-2.

III. COMPETITION REGULATION AND INDUSTRIAL POLICY[25]

A. The KFTC's central role

The KFTC assumes the principal role in developing and implementing the nation's competition policy and law. Several statutory provisions regulating various industries and measures of other government agencies conflict with competition rules of the MRFT Act and the policies of the KFTC. The MRFT Act clearly declares: "This Act shall not apply to the acts of an enterprise conducted in accordance with any other law or decree."[26] Nevertheless, the KFTC is assigned a competition advocacy role towards administrative agencies. The heads of competent government agencies are obligated to consult or give notice to the KFTC in advance when they wish to propose legislation, rules or amendments containing anticompetitive provisions such as determining prices or terms of transactions, restricting market entry or business activities, authorizing concerted action, or supporting the anticompetitive practices of a trade association. The same obligation applies when the agencies' heads wish to approve or implement measures involving anticompetitive practices by enterprises or trade associations.[27] The KFTC is authorized to give advice to the heads of the competent government agencies in order to modify such anticompetitive provisions or measures.[28] Nevertheless, although the head of the other agency may respect the KFTC's advice, the advice is not legally binding.

B. Competition law's conflict with industrial policy

Korea has attempted to harmonize competition law enforcement with the nation's industrial policy implementation. When explicit provisions in a specific statute exclude the application of the MRFT Act, no conflict arises. Moreover, the MRFT Act declares that it does not

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25 *See* Jung & Chang, *supra* note 1, at 714–22.

26 MRFT Act, art. 58.

27 *Id.* at art. 63, ¶¶ 1–3.

28 *Id.* at art. 63, ¶ 4.

apply to legitimate acts undertaken pursuant to other statutory provisions. Even in the chapter prohibiting cartels, exemptions are provided, mostly reflecting industrial policies, such as authorized cartels to allow for industrial restructuring or research and development.[29]

A difficult issue arises when administrative guidance is involved. Administrative guidance has been utilized by Korean government agencies for the past several decades in order to implement their policies in various industrial sectors. Administrative guidance is rarely based on statutory provisions. If administrative guidance itself mandates a specific concerted act based on a statutory provision, it will be exempt from the general prohibition of the MRFT Act.[30] However, in most cases, administrative guidance is not based on statutes or decrees issued by the authorities; it merely exerts de facto force on the recipient enterprises. Korean courts, as well as the KFTC, have not permitted the denial of illegality for prohibited concerted acts that have been initiated as a result of administrative guidance rendered without statutory mandate.[31] A decision by the Seoul High Court confirms this position:

> Administrative guidance is a mere non-authoritative de facto act and cannot require obedience. Hence, the petitioner trade association had to act after independently deciding its legality in light of the MRFT Act. . . . Even if the petitioner committed the act in question as a result of the administrative guidance given by the Ministry of Commerce and Industry, the illegality of the act cannot be denied. Thus the KFTC's corrective order should not be deemed to be contrary to the rule of estoppel.[32]

Though administrative guidance is not a defense to the illegality of a challenged concerted act, the KFTC has shown some sympathy in cases where the act is initiated as a result of an agency's guidance by reducing the penalties. In *Three Beer Brewers' Price Collaboration*, the Supreme Court sustained the rebuttal of collusion presumption provided in the MRFT Act, based on the circumstantial evidence of the

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[29] *Id.* at art. 19, ¶ 2.

[30] *Id.* at art. 58.

[31] *See* MEONG-CHO YANG, ECONOMIC LAW 152–53 (2008).

[32] *In re* Korean Fed. of Nonferrous Metal Indus. Coops., 91 Gu 2030 (Seoul High Ct. Jan. 29, 1992).

National Tax Service's (NTS) administrative guidance.[33] In this case, the identical price hike of the beer brewery companies was challenged by the KFTC. But the petitioners contended that their identical prices were the result of the ex-factory price reporting requirements imposed by the NTS, which has the authority to levy and collect a liquor tax. Through its report-accepting procedure, the NTS has played the role of controlling excessive price increases.

IV. HORIZONTAL AGREEMENT

A. Prohibition as a rule

Article 19 paragraph 1 of the MRFT Act enumerates the concerted acts that are prohibited as "unduly restricting competition," including acts that:

1. fix, maintain, or change prices;
2. determine terms and conditions for transactions of goods or services, or terms of payment;
3. restrict production, delivery, transportation, or transaction of goods or services;
4. limit the business territory or business partners;
5. hinder or restrict the establishment or extension of facilities or the installation of equipment necessary for producing goods or rendering services;
6. restrict sorts or specifications of goods or services when produced or rendered;
7. consist of jointly carrying out and managing the main parts of a business, or establishing a company for the purpose of jointly carrying out the main parts of a business;
8. determine a winner, a successful bidder, a bidding price, or a contract price in a bidding process or auction; or
9. substantially lessen competition in a particular field of business by means, other than those under subparagraphs 1 to 7, interfering with or restricting the activities or conduct of business.

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[33] Three Beer Brewers' Price Collaboration, 2001 Du 1239 (Sup. Ct. Feb. 28, 2003).

B. Agreement and presumption

As the wording of the cartel provisions requires a meeting of minds, by way of contract, agreement, or resolution among participants, proof of formal agreement is not required for challenging a concerted act. Still, the burden of proof lies on the KFTC, or on the plaintiff in a damages suit. In order to alleviate the evidentiary difficulties, an earlier amendment of the MRFT Act adopted a presumption clause.[34] An agreement is presumed where two or more enterprises are more likely to collaborate in one of the itemized types of concerted acts, in view of the characteristics of the business sector concerned, the nature of the goods or service, the economic background of the act in question, or the number and types of contacts among participants.

The language of the presumption clause was adjusted in the 2007 amendment. Previously, the presumption clause had not mentioned "plus factors," and so the Korean Supreme Court held that showing a plus factor or circumstantial evidence is not required in order to invoke the presumption provision.[35] However, the Court allowed the rebuttal of the presumption on the ground that the participants' business policy of "adopting higher prices helps satisfy consumers' luxurious tendency,"[36] which contributed to the spiral price hikes in the domestic coffee market.

C. Per se or rule of reason

The MRFT Act's cartel provision prohibits "improper concerted acts," which are defined as "unduly or improperly restricting competition." Court decisions, as well as the statutory language, do not mention whether per se illegality or rule of reason analysis applies to cartels. The KFTC has declared its enforcement policy of challenging hard-core cartels by utilizing a per se rule.[37] However, the statutory language does not fully sustain the authorities' resolve. The KFTC

34 MRFT Act, art. 19, ¶ 5.

35 *In re* Dongsuh Food Co., 99 Du 6514/6521 (Sup. Ct. Mar. 15, 2002).

36 *Id*.

37 KFTC, Fair Trade White Paper 22 (1999) (on file with author).

takes price-fixing and bid rigging as the most common examples of hard-core cartels. Even if the statutory provision of the MRFT Act prohibits only cartels "improperly" restricting competition, "improperly" should not be read to require balancing anticompetitive effect of the concerted act in question with its procompetitive effect.

A system of authorizing certain concerted acts is provided in article 19, paragraph 2 of the MRFT Act. This provision empowers the KFTC to authorize certain concerted acts that meet the conditions prescribed in the provision: the cartel in question is organized for achieving the industry rationalization, research and development, or overcoming economic depression. The enforcement decree on this provision details the prerequisites for the authorization by the KFTC. The KFTC has been hesitant to authorize concerted acts proposed by participants based on these exceptions. Nevertheless, Korean anticartel enforcement may hardly be classified as applying a per se rule.

As a condition for utilizing the authorization system, the cartel participants are required to file an application for authorization to the KFTC prior to conducting the concerted act. If the concerted act in question is performed and challenged by the KFTC, the itemized list of acts eligible for authorization cannot be invoked as a defense in the court proceeding or in relation to KFTC proceedings.[38]

In interpreting the language "improper" concerted acts, competing views have been asserted. One view considers improper to mean situations in which the anticompetitive effect of a cartel outweighs its proconsumer effect. For instance, if the participants agree to standardize the volume and size of their products, consumers can easily compare actual prices. The other view considers that a cartel is not improper when the anticompetitive impact is relatively small or negligible and contends that the MRFT Act outlaws only those concerted acts organized by enterprises with significant market power, i.e., whose anticompetitive effect is considerable.[39] The latter view empha-

[38] In one exceptional case, the Korean Supreme Court pardoned a price fixing arrangement among the tourism agencies in *Jeju Island* by invoking the legislative intent of the authorization system. *In re* Jeju Island Tourism Agents' Improper Concerted Acts, 2003 Du 11841 (Sup. Ct. Sept. 9, 2005).

[39] *See* Yang, *supra* note 31, at 163–64.

sizes limited resources of the KFTC, contending that it needs to concentrate on cases of significant value.

D. Enforcement practice

It is hard to find a KFTC decision clearly demonstrating a rule of reason approach in cartel cases. At times, industrial difficulties or unavoidable circumstances have been taken into consideration when calculating the amount of administrative fines. However, such considerations did not turn an improper concerted act into a justifiable one.

Almost all cartel cases are closed by the KFTC with an order to discontinue the illegal act, an order to undertake corrective measures, the imposition of an administrative fine, and the publication of the adverse decision. Quite recently, the yearly total amount of surcharges or administrative fines imposed by the KFTC against cartels doubled or tripled compared to the previous year: 307.0 billion won (approximaely US$ 307 million) in 2007, 110.5 billion won in 2006, 249.3 billion won in 2005, 28.8 billion won in 2004, and 109.8 billion won in 2003. The 2004 figure was exceptionally low.

As the KFTC has more stringently enforced the cartel provision in recent years, the number of criminal cases prosecuted has also increased. In Korea, the power to indict criminals lies exclusively with the National Prosecutor's Office. A complaint filed by the KFTC is the prerequisite for the indictment[40] for the major MRFT Act violations. The KTFC has often filed such complaints with the National Prosecutor's Office, and the violators have been indicted. However, prison sentences against individuals have never been imposed; criminal sanctions for antitrust violations have been limited to criminal fines imposed on companies or their officers.

V. VERTICAL RESTRAINT

A. Overview

The MRFT Act uses the term unfair business practices for the chapter that deals with most types of vertical restraints. Nevertheless, the MRFT Act has a separate chapter forbidding resale price maintenance, which is condemned by a per se rule.

[40] *See* MRFT Act, art. 71, ¶ 1.

Types of unfair business practices regulated by the MRFT Act may be classified into two groups. The first group consists of business practices which are prohibited due to their anticompetitive nature. The second group consists of business practices which are prohibited due to their unreasonableness or unfairness. The relevant guidelines of the KFTC analyze "unfairness," i.e., use of unfair means of competition and the unfair content of a transaction.[41]

It may seem surprising to regulate the unfair content of a transaction in a competition law whose original purpose might be thought to be promotion of competition in a relevant market. Nevertheless, surpassing the role of "pure" competition laws, the MRFT Act has assumed a role of preserving transactional fairness through allowing small enterprises the freedom to exercise their business judgment. It is fair to say that the KFTC has been vigorous in enforcing the provisions regulating vertical restraints to achieve this objective.

Most of the types of practices regulated by the chapter on the abuse of market-dominant position overlap with those in the chapter on unfair business practices. As a practical matter, the authorities prefer to apply the provisions against abuse of market-dominant position, since the maximum penalty in that chapter is much higher than that for unfair business practices.

In order for business conduct to be condemned as an unfair business practice under the statute (i) it must fall within the categories set forth in article 23, paragraph 1 of the MRFT Act, (ii) it must tend to be detrimental to fair trade, and (iii) the specific conduct must be set forth in a list of unfair business practices set out in the MRFT Act Enforcement Decree.

The list of unfair business practices includes:

1. unfairly refusing to deal or discrimination against a specific partner;
2. unfairly excluding competitors;
3. unfairly inducing or coercing a competitor's customer;
4. unfairly taking advantage of one's bargaining power in transacting with others;

[41] KFTC, Unfair Business Practices Examination Guidelines, *available at* http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=14.

5. unfairly restraining the business activities of a trade partner or unfairly impeding the business activities of other enterprises; and
6. unfairly supporting a specially related person or another company through providing payment in advance, a loan, manpower, real estate, negotiable instruments, goods, services, or intellectual property rights, or by entering into transactions using substantially more favorable terms than those granted to others.

The last category of unfair business practices was introduced in the 1996 amendment to the MRFT Act. This provision aims at regulating so-called intra-chaebol (business group) transactions which are discriminatory against outsiders and might distort competition on the merits, resulting in protection of chaebol-related enterprises in the relevant market, even though these related companies would not have succeeded in a truly competitive market. The issue of chaebol inefficiency and the extent to which the major corporate conglomerate groups dominate the national economy have engendered substantial public concern, especially in the last decade, after the 1997 financial crisis which exposed the inefficiency of many chaebol-related enterprises.

B. Resale price maintenance

As a rule, the Korean antitrust regime has applied a per se rule against resale price maintenance,[42] and the KFTC has strongly enforced this rule. In line with other jurisdictions, exceptions are allowed for literary works such as books, magazines and newspapers.[43]

Stringent enforcement has caused most resale price maintenance agreements to be abandoned. However, considering the evidentiary difficulties in proving secret vertical restraint agreements, it is doubtful whether such practices have been actually eradicated.

A significant change has taken place in the resale price maintenance policy with the 2001 amendment to the MRFT Act, which introduced a rule of reason analysis on resale price maintenance through setting of maximum prices. The amendment prescribes that, when a justifiable reason exists, it is not unlawful to conclude a contract term

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[42] MRFT Act, art. 29, ¶ 1.

[43] *Id.* at art. 29, ¶ 2.

that prohibits the pricing of goods or services higher than the designated ceiling price.[44] The rationale for permitting maximum resale price maintenance is that such practices would enable a manufacturer to prevent its distributors from gaining excessive profits and thus would improve the manufacturers' business image or reputation among consumers.

C. *Cases of the KFTC and courts.*

1. UNREASONABLE REFUSAL TO DEAL Lotteria Company, a prominent franchiser in the family restaurant business revoked its franchise agreement with several franchisees. The Supreme Court had declared a standard for unreasonable refusals to deal:

> Unreasonable refusals to deal can be found, where a franchiser deprives a franchisee of continuous business opportunity and the franchisee's business activities are hampered although no substantial reason for discontinuation of business relation exists such as a breach of contract on the part of a franchisee; or where a franchiser utilizes refusal to deal as a means to achieve or effectuate unjustifiable control over a franchisee.[45]

2. PREFERENTIAL TERMS FOR AFFILIATED COMPANIES Concerning discriminatory practices, the Supreme Court has endorsed the KFTC's dual criteria in its enforcement. In cases concerning discriminatory prices and transactional terms, the KFTC bears the burden of proving unreasonableness of the discrimination in question. However, the respondent company has to prove reasonableness in case of discrimination in favor of an affiliated company.[46]

3. UNREASONABLE DUMPING The KFTC has outlawed extremely low prices as an exclusionary practice. In its first case,[47] Lucky Corporation, a very popular toothpaste manufacturer in Korea, made a bid to the Ministry of Defense of 1 won (equivalent to ten percent of 1 US cent) per tube of toothpaste when the Ministry invited bids for the supply to the military in 1983. The market price for that

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44 *See id.* art. 29, ¶ 1.

45 *In re* Lotteria Co., 2000 Du 833 (Sup. Ct. Dec. 11, 2001).

46 *See In re* Korea Nat'l Housing Corp., 2002 Du 332 (Sup. Ct. Mar. 10, 2006).

47 Lucky Corp., No. 83-12 (KFTC June 15, 1983).

merchandise at that time was approximately 100 won a tube. This bid was condemned by the KFTC.

In another case, Ankook Oil Corporation made a 1 won bid for the supply of one year's supply of generator turbine lubricant; this too was condemned by the KFTC.[48] It was a strikingly low price, compared to the expected bidding price of 189 million won for that quantity. The bidder wanted to continue to supply that turbine lubricant for as long as twenty years after winning the bid, as the purchaser cannot change the specification of turbine oil once applied to its generators. Though the extraordinary low price may benefit the buyer, it could exclude the bidder's competitors from the market at the same time. Once the competitors leave the market, the bidder who offered the lowest price can enjoy the monopolistic profit.

4. UNFAIR ENTICEMENT OF COMPETITORS' CUSTOMERS Competition has been very fierce in the Korean pharmaceutical industry, and manufacturers and suppliers of medicine have vigorously competed in gaining contracts from major hospitals. In a 1994 case, the KFTC condemned fourteen pharmaceutical companies for paying substantial amounts of money to hospitals and their staff doctors in the hope of obtaining additional business.[49] Korean antibribery statutes apply to the cases in which government officials are involved. The KFTC has utilized the MRFT Act in order to discipline private hospitals and their doctors, as well as the pharmaceutical industry.

5. RESTRICTIVE PRACTICES The most common types of vertical restraints condemned by the KFTC have been restrictions on business territories or restrictions on who could transact with the other party. In *Korea Highway Corporation*, Korea Highway Corporation designated one oil refinery company as the exclusive supplier of gasoline and diesel oil to all gas stations doing business in the service areas located alongside the highways constructed and maintained by Korea Highway Corporation.

The Supreme Court quashed the KFTC decision, which had found the restriction illegal as an unfair business practice. The Supreme

[48] Ankook Oil Corp., No. 9407 Gyeong Jeong 430 (KFTC Nov. 9, 1994).

[49] *In re* Fourteen Pharm. Cos., No. 9309 Il 577 (KFTC Mar. 3, 1994).

Court took into consideration all circumstances, e.g., locational characteristics of highway gas stations, the special nature of gasoline and diesel oil as well as their relevant markets, and the background of the operational agreements between Korea Highway Corporation and the gas stations regarding their service areas.

The Court concluded that Korea Highway Corporation's designation of a single oil supplier did not constitute an unfair restrictive practice leading to anticompetitive effects.[50] The reasons given by the Court included highway gas stations' locations, which were regarded as the most significant factor. Since highway gas stations operate on the sites owned by Korea Highway Corporation, which is in charge of the safety and maintenance of highways, the Corporation was justified, for reasons of public safety, in restricting oil tankers from coming on to its property.

VI. MERGERS

A. Statutory provisions

Previous merger provisions of the MRFT Act controlled two categories of combination of enterprises. The first category consisted of anticompetitive mergers, combinations that might substantially restrict competition in the relevant market. The second category consisted of unfair mergers, combinations realized by means of compulsory or any other unfair method. No unfair merger case had ever been investigated by the KFTC, so the 2007 amendment of the MRFT Act repealed this provision.

Article 7 paragraph 4 of the MRFT Act presumes a substantial restriction of competition in merger cases. Substantial restraint of competition is presumed where:

1. aggregate market share of the combined enterprises exceeds fifty percent, or where the total market share of the combined enterprises plus that of one or two other enterprises exceeds seventy-five percent;[51]
2. the aggregate market share of the combined enterprises is the largest in the relevant market; and

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[50] Korea Highway Corp., 99 Da 30817/30824 (Sup. Ct. Oct. 6, 2000).

[51] *See* MRFT Act, art. 4.

3. The difference between the aggregate market share of the combined enterprises and the market share of the second largest enterprise exceeds twenty-five percent of the aggregate market share of the combined enterprises.

Separately, the presumption applies where a large company acquires another company in a market where small or medium-sized enterprises occupy not less than two-thirds of the whole market share and the large company secures a market share of not less than five percent.

B. *Notification System*

1. TYPES OF BUSINESS COMBINATIONS TO BE NOTIFIED Under the MRFT Enforcement Decree, if any enterprise having aggregate assets or turnover (including the assets or turnover of all affiliated companies) of 100 billion Korean won (approximately US$100 million) or more[52] participates in a combination of enterprises with a counterpart enterprise having aggregate assets or turnover of 200 billion Korean won (US$200 million) or more,[53] it shall notify KFTC. The MRFT Act enumerates five types of business combinations subject to merger filing[54]:

1. where a company holds (directly or through an affiliate or a specially related person) twenty percent or more of the total number of shares issued by another company whose stock is not listed with the Korea Stock Exchange (fifteen percent or more in case the acquired company is a listed corporation);
2. where a company which has held not less than the percentage provided in above 1. of another company becomes the largest shareholder of the company by acquiring more shares;
3. where an interlocking directorate occurs (except for the case of interlocking directors in affiliated companies);
4. where a merger among two or more companies or acquisition of the whole or substantial portion of the business of another enterprise is proposed; or

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[52] MRFT Enforcement Decree, art. 18, ¶ 1 (1981 and as amended), *available at* http://eng.ftc.go.kr.

[53] *Id.* at art. 18, ¶ 2.

[54] MRFT Act, art. 12, ¶ 1, proviso.

5. where a company has engaged in the incorporation process and becomes the largest shareholder of the newly established company.

2. POST-MERGER NOTIFICATION AND PRE-MERGER NOTIFICATION Post-merger notification is the general rule with a few exceptional pre-merger notification requirements. A notifying company should file its report with the KFTC within thirty days after the date of the consummation of the contract for business combination.[55]

Larger companies should file the merger notification prior to the conclusion of the pertinent transaction. Larger companies in this context are those with total assets or turnover of two trillion Korean won (approximately, US$200 million) or more.[56] However, in case of an interlocking directorate, pre-merger filing is not needed regardless of the size of the filing company. Parties who have filed a merger notification may not register the merger, execute the contracts for the takeover of business, or acquire stock until thirty days after such a filing. This standstill period may be shortened or extended to a maximum of ninety days at the KFTC's discretion.[57]

C. *Screening process*

Additionally, before the formal notification, parties who intend to combine enterprises may request the KFTC to screen their proposal and determine whether the proposed combination may be categorized as one which substantially lessens competition.[58] Upon this request, the KFTC is required to give notice of its determination within thirty days.[59] However, the KFTC may, if necessary, extend such period up to not more than ninety days from the expiration of original thirty days.[60]

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[55] *Id.* at art. 12, ¶ 6.

[56] MRFT Enforcement Decree, art. 12-2.

[57] MRFT Act, art. 12, ¶ 7.

[58] *Id.* at art. 12, ¶ 8.

[59] *Id.* at art. 12, ¶ 9.

[60] *Id. See* KFTC, Fair Trade White Paper 18 (2005) (on file with author). *See also* Yong Seok Ahn & Youngjin Jung, *Merger Control in Korea*, 2004 ASIA PAC. ANTITRUST REV. 62, 63–64 (2004).

D. Review and corrective measures

Upon receiving a formal notification or a request for screening, the KFTC examines the merger transaction in question to decide whether it would substantially restrain competition in the relevant market. If the KFTC finds that the business combination would substantially lessen competition in a particular field of business, the KFTC may prohibit the combination of enterprises, or order the disposal of acquired stock, the resignation of the common director, the transfer of acquired assets, or any other corrective measures.

Interestingly, one of the other corrective measures taken by the KFTC has been to set a ceiling on the prices of merchandise sold by the combined enterprise. In the case of Hyundai Motors' acquisition of Kia Motors Corp., the KFTC approved the business combination, but ordered a corrective measure to set a ceiling on the price increase ratio for trucks made for domestic sales by Hyundai and Kia as not higher than the price increase ratio for their trucks for export.[61] This measure was aimed at protecting the interests of domestic consumers, since Hyundai and Kia could not have increased the prices of their trucks in the world market as high as in the national market.

The corrective measure of designating a ceiling on prices or a price increase ratio might be peculiar as a measure against an anticompetitive merger. Nevertheless, the KFTC rendered such a decision when it had to approve a merger based on policy considerations overriding the competition law analysis.

In another acquisition case, Hite Beer Corp.'s acquisition of Jinro Soju Co., the KFTC found the combination anticompetitive. However, the KFTC did not prohibit the acquisition itself. Rather, the KFTC set a ceiling on the price increase ratio of the products to be sold by the combined companies as not higher than the national average price increase ratio of consumer prices in the five years following the date of receipt of the KFTC corrective order.[62] Moreover, the KFTC ordered

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[61] *In re* Hyundai Motors Corp.'s Bus. Combination, No. 99-43 (KFTC April 7, 1999).

[62] *In re* Hite Beer Corp.,'s Bus. Combination, No. 2006-009, (KFTC Jan. 24, 2006).

the respondents not to consolidate their marketing staff as well as their facilities for five years after the date of receipt of the KFTC's corrective order. The KFTC intended to prohibit the parties from gaining extra profits from the anticompetitive merger, even if the KFTC was obliged to allow the merger on the other policy grounds.

E. Exceptions

Even if the KFTC finds substantial lessening of competition in the business combination in question, it cannot require corrective measures if the combination falls under two exceptions: (i) the enhancement of efficiency attainable through the combination in question is greater than the adverse effect produced by restriction of competition; and (ii) the combination in question is made with a failing company, such as a company whose total capital on its balance sheet is less than its paid-in capital for a significant period of time.[63]

VII. EXCLUSIONARY CONDUCT

A. Overview

The MRFT Act prevents the abuse of market-dominant position.[64] Under the current Korean antitrust regime, existing monopolies do not have to be dissolved or divided. Abusive acts of monopolists or oligopolists are regulated according to a separate chapter of the MRFT Act. Where an enterprise does not fall under the definition of a market-dominant enterprise, the same exclusionary conduct is also regulated according to the separate chapter of the MRFT Act addressing unfair business practices.[65] Maximum penalties against market-dominant enterprises are more severe than those against ordinary enterprises, even if their anticompetitive activities can be classified as the same or a similar type of illegal conduct. Thus, many similar types of violations are itemized in both the abuse of a market-dominant position provisions and unfair business practices. If a violator, by virtue of its size, falls under the definition of market-dominant enter-

[63] MRFT Act, art. 7, ¶ 2.

[64] *Id.* at art. 3-2.

[65] *Id.* at chap. 5.

prise, heavier penalties will be imposed: up to 3 years' imprisonment and a fine of up to 200 million won. Non-market-dominant firms are subject to more lenient penalties: no longer than two years' imprisonment and a fine of up to 150 million won.[66]

B. Examples of abusive ccts

The MRFT Act, article 3-2, paragraph 1 enumerates five types of abusive activities which might be engaged in by market-dominant enterprises, including

1. unreasonably determining, maintaining, or changing the price of commodities or services;
2. unreasonably controlling sale of commodities or provision of services;
3. unreasonably interfering with the business activities of other enterprises;
4. unreasonably impeding the market entry of a new competitor; and
5. engaging in improper business transactions to exclude competitors or an act likely to significantly harm consumer interest.

The MRFT Enforcement Decree details the categories and standards for the above illegal acts.[67] Interestingly, in terms of the price abuse, the Enforcement Decree provision covers only the case of price change; price maintenance is omitted.[68] Thus, where the price of raw materials has been sharply lowered and the market-dominant enterprise does not decrease the selling price of the commodity concerned, such maintenance of price cannot be condemned under the current provision.

Quite recently, the KFTC attempted to revise the relevant provision in the Enforcement Decree in order to extend the coverage of the price control provision against market-dominant enterprises. Under the new regime even if there is no price change, the KFTC may intervene and order a price decrease in such commodities whose production cost is much lower and whose rate of return is much higher than

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66 *Id.* at arts. 66, 67.

67 MRFT Enforcement Decree, art. 5, ¶¶ 1–5.

68 *Id.* at art. 5, ¶ 1.

the average thereof in national commodity markets. The business community strongly criticized the KFTC's legislative attempt on the ground that price control by means of competition law enforcement is not appropriate in light of the purpose of competition law, and no legislative example can be found in any other advanced nation.[69]

C. *The KFTC and court decisions*

1. ENFORCEMENT POLICY[70] Among the 400 or more cases handled annually by the KFTC, the number of abuse of market-dominant position cases has remained small. In 2005, only one abuse of market-dominant position case was reported. This small number is in striking contrast to the large number of unfair business practice cases, which reached 341 in the same year. The KFTC has declared a policy of devoting more enforcement resources to regulating the abuse of market dominance in the future.[71]

2. *KOREAN AIRLINES* The KFTC condemned abusive acts carried out by Korean Airlines Corp. as early as in 1990.[72] Up until the late 1980s, Korean Airlines enjoyed a monopoly position in the domestic passenger air transportation market. The Korean government then licensed another carrier, Asiana Airlines, to promote competition. Attempting to block the entry of the new airline, Korean Airlines asked its ticketing agents to choose only one business partner, either Korean Airlines or Asiana Airlines. The KFTC found that Korean Airlines' act could be condemned as "unreasonably interfering in competitor's business activities by exploiting its market-dominant position," as provided in the MRFT Act, article 3-2, paragraph 1, item 3. The KFTC rendered a cease and desist order against the respondent.

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[69] *Strengthening the Price Restrictions Against Market-Dominant Enterprises is Actually Price Control*, CHOSUN DAILY, Oct. 4, 2007, at B2.

[70] For further details, see Sang-seung Yi & Youngjin Jung, *A New Kid on the Block: Korean Competition Law, Policy and Economics,* 3 COMPETITION POL'Y INT'L 153, 173–77 (2007).

[71] The KFTC, Fair Trade White Paper, 131, 132 (2006) (on file with author).

[72] Abuse of Market-Dominant Position by Korean Airlines, No. 90-14 (KFTC July 6, 1990).

3. *MICROSOFT* In 2006, the KFTC rendered a landmark decision against Microsoft Corp. and Microsoft Korea Corp. (Microsoft).[73] In its decision, the KFTC found that Microsoft had violated article 3-2 of the MRFT Act, which prohibits the abuse of a market-dominant position. The decision found Microsoft's bundling of its Windows server and Window Media Service to be unlawful. The decision also condemned Microsoft's bundling of its Windows Personal Computer Operating System with Windows Media Player as well as with Windows Messenger.

The KFTC ordered Microsoft to discontinue the bundling within 180 days of the KFTC's order and imposed an administrative fine totaling 32.49 billion won (approximately US$ 32.5 million). In its decision, the KFTC found that Microsoft's bundling or tying practices "unreasonably interfered with the business activities of other enterprises" and was "likely to significantly harm consumer interests."[74]

Microsoft brought a lawsuit against the KFTC's corrective order and surcharge. However, in October 2007, Microsoft withdrew its appeal after it had lost a similar antitrust case in the European Court of First Instance.[75] The KFTC agreed to close the case, and the case was thus concluded.

4. POSCO'S ABUSE OF MARKET-DOMINANT POSITION DENIED Quite recently the Supreme Court reversed[76] the Seoul High Court's decision[77] which affirmed the KFTC's corrective order and the imposition of a surcharge against Posco Corp., a very large Korean steel manufacturer (Posco).

[73] Abuse of Market Dominant Position by Microsoft Corp. and Microsoft Korea Corp., No. 2006-42 (KFTC Feb. 24, 2006), *available at* http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=18 (No. 4 MS Case).

[74] MRFT Act, art. 3-2. *See also* Sejin Kim, *The Korea Fair Trade Commission's Decision on Microsoft's Tying Practice: The Second-Best Remedy for Harmed Competitors*, 16 Pac. Rim L. & Pol'y J. 375–404 (2007) and Youngjin Jung, *Abuse of Market Dominance in Korea: Some Reflections on the KFTC's* Microsoft *Decision*, 36 Legal Issues Econ. Integration 1 (2009).

[75] Case T-201/04, Microsoft v. Comm'n, 2004 E.C.R. II-4463.

[76] Posco Corp., 2002 Du 8626 (Sup. Ct. Nov. 22, 2007).

[77] Posco Corp., 2001 Nu 5370 (Seoul High Ct. Aug. 27, 2007).

In its 2001 finding against Posco,[78] the KFTC found that Posco had abused its market-dominant position by refusing to supply the hot rolled coil necessary for the production of cold rolled sheet steel to Hyundai Hysco Co., a subsidiary of Hyundai Motors Corp. (Hysco). Hysco built a facility to produce cold rolled sheet steel for auto manufacturing as early as 1999 and requested Posco to supply hot rolled coil several times. However, Posco refused to deal with Hysco, worrying that Hysco's entry into this market would reduce Posco's market share.

The KFTC recognized that the market share of Posco reached 79.3% in the domestic hot rolled coil market and 58.4% in the domestic cold rolled sheet steel market. Thus the KFTC confirmed Posco's market-dominant position.

The KFTC then found that Posco's refusal to supply was unreasonable and fell under the abuse of a market-dominant position on the ground that Posco had interfered with the business activities of Hysco, and thus Posco had intended to extend its dominant position in the market of cold rolled sheet steel. The KFTC indicated that Posco's refusal to deal had caused substantial difficulties in Hysco's business, forcing Hysco to bear additional costs, such as freight, tariff, loading and unloading charges, and subjecting it to the risks of acquiring raw materials from overseas because of unstable supply, problematic transportation, and foreign exchange fluctuations. Moreover, Hysco's failure to secure a domestic supplier would have weakened its bargaining power in its dealings with foreign suppliers, resulting in adverse consequences for the national economy. The KFTC, therefore, rendered a corrective order and imposed a surcharge of 1,640 million won (approximately US$ 1.64 million).

Posco brought an action to quash the KFTC decision, but the Seoul High Court affirmed. Posco then appealed the case to the Supreme Court, which reversed the Seoul High Court's judgment. The Supreme Court agreed with Seoul High Court and the KFTC in recognizing the market-dominant position of Posco in the relevant market, but did not agree in finding unreasonableness with regard to Posco's refusal to deal:

[78] Posco Corp., 2001 Gyeong Chog 0389 (KFTC Apr. 12, 2001).

> The KFTC, in argument that Posco's refusal to deal fell under an abuse of market-dominating position, must prove that such a refusal tended to raise prices, decrease outputs, deter innovation, reduce the number of prominent competitors, impair the industrial diversity, etc. resulting in restraining competition. Only after the above consequences are proven, it may be presumed that the act in question tended to restrict competition and that such an intention or purpose existed at the time of the act. Otherwise, comprehensive consideration should be exerted on such issues as the circumstances and motivation of the refusal to deal, characteristics of the relevant market, the degree of harm suffered by the refused party, the change of the price and output, deterrence to innovation, or reduction of diversity. And then, it should be decided whether the refusal to deal in question tended to cause the above restraint of competition and such an intention or purpose existed. . . .
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> . . . .
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> Unless Hysco could not purchase hot rolled coil from any other suppliers and was actually excluded from the new entry due to Posco's refusal to deal, the refusal in and of itself is not sufficient to be defined as an unreasonable refusal to deal which tended to restrain competition. Rather, in this case, despite the refusal by Posco, Hysco imported its needed hot rolled coil from Japan and carried out its production and sale of cold rolled steel plate and gained net profit. Consequently, the domestic market for cold rolled steel plate has expanded. . . . In light of the lack of evidence showing plausible restraint of competition such as decrease in outputs or a hike in prices. Hysco's business difficulties caused by Posco's refusal to deal would not suffice to find that the refusal in question tended to restrict competition at the time of the challenged act.[79]

VIII. CONCLUSIONS

A nation's competition policy cannot stand alone disregarding its industrial, social and economic surroundings. The degree of sophistication in Korean competition law during early 1980s was somewhat puzzling to the international community, because, at that time, government regulation of industrial sectors was prevalent. With its chronic trade deficits, the Korean government had to overlook anticompetitive business activities if they were deemed to be helpful in strengthening domestic businesses' international competitiveness. The MRFT Act might have been enacted as a mere acknowledgment of the issue, but was not a serious attempt to deal with competition issues.

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[79] *Posco*, 2002 Du 8626.

With a short history of competition law enforcement, Korea has become quite successful in competition advocacy and has gained social support from business circles as well as from the general public in achieving more active enforcement. Many observers attribute Korea's successful antitrust enforcement in the past decade to the integrity of the KFTC officials and to the procompetition consciousness generated in the general public.

Currently, large businesses have complained about excessive enforcement of the MRFT Act and have criticized the KFTC's restrictions on the freedom of management decisionmaking with a total investment ceiling being imposed on large business groups. They argue that this restriction has hindered their business expansion plans, which are necessary for them to achieve competitiveness in the global market.

As regards enforcement tools, the KFTC has relied heavily on surcharges or administrative fines. In 2007, fines totaling 410 billion won (US$410 million) were imposed on antitrust violators. This amount is striking when compared to 175 billion won in 2006. The sharp increase in the amount of surcharges reflects the KFTC's strong determination to punish antitrust violations. Nevertheless, several critics suggest that criminal sanctions would be more effective than surcharges. They insist that the burden of paid surcharges will be passed on to consumers; thus the actual violators—officers of the respondent companies—tend not to be deterred by surcharges which they do not have to pay personally. However, a drastic policy shift concerning enforcement measures is not expected.

The Korean leniency program with its new "amnesty plus" program may become more effective in assisting cartel investigations in coming years. Antitrust enforcement cooperation has been stressed by the Korean competition agency through active involvement in international competition law organizations such as the International Competition Network.[80] Several bilateral cooperation arrangements have also been entered into by the Korean government.[81]

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[80] *See* International Competition Network, http://www.internationalcompetitionnetwork.org/.

[81] *See* Memorandum of Understanding on Cooperation between the Fair Trade Commission of the Republic of Korea and the Competition Directorate-

Korean antitrust enforcement is praiseworthy as a success story especially in light of the nation's decades-long growth-oriented industrial policy. The new administration of President Lee Myung-bak, who has long expressed probusiness sentiments, may result in a setback in antitrust enforcement, starting with the abolition of the total investment ceiling set for each affiliated company of large business groups. However, it is hoped that the KFTC's role of competition advocacy will be sustained.

General of the European Commission (Oct. 28, 2004), Cooperation Arrangement Between the Fair Trade Commission of the Republic of Korea and the Australian Competition and Consumer Commission Regarding the Application of their Competition and Consumer Protection Laws (Sept. 29, 2002). English versions of these bilateral cooperation agreements are on file with author. *See also* Joshua, Camesasca & Jung, *supra* note 11, at 393–94.

The Antitrust Bulletin

Economics

Allocating costs in Ninth Circuit predatory pricing cases: Marsann Co. v. Brammall, Inc. *and its problematic progeny,* Inglis v. Continental Baking *and* Thales v. Matsushita

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I. INTRODUCTION

Predatory pricing remains an active area in antitrust law, and cases continue to be brought before federal and state courts, causing the economics of predatory pricing to be revisited with some frequency.[1]

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[1] Daniel Crane indicates that "hundreds" of predatory cases have been filed since the restrictive Supreme Court decisions. Daniel A. Crane, *The Perverse Effects of Predatory Pricing Law*, 28 REG. 26 (2005). For a list of reported cases since 1993, see Daniel A. Crane, *The Paradox of Predatory Pricing*, 91 CORNELL L. REV. 1, 26 n.118 (2005).

Recent cases include *Bay Guardian Co., Inc. v. NT Media LLC*[2]; *Kinetic Concepts, Inc. v. Hillenbrand Industries, Inc.*[3]; *LePage's Inc. v. 3M Co.*[4]; and *United States v. AMR Corp*.[5] A key concept in these cases is whether prices were set below some measure of costs, a threshold issue in predatory pricing analysis.[6] Despite the fact that the Supreme Court has recently given considerable attention to predatory pricing, it has still not resolved splits in the circuit courts regarding the appropriate measure for determining when a price is "below cost."[7] The Supreme Court has declined in three recent, important cases, *Brooke Group*,[8] *Cargill*,[9] and *Matsushita*,[10] to determine the appropriate measure of cost below which prices must be set in order to be condemned as predatory. In *Brooke Group*, the Court merely required that prices be below "some measure of incremental cost."[11] This article

2 Bay Guardian Co., Inc. v. NT Media LLC, No. 04-435584 (Cal. Sup. Ct. filed Oct. 19, 2004).

3 Kinetic Concepts, Inc. v. Hillenbrand Indus., Inc., 262 F. Supp. 2d 722, 725–26 (W.D. Tex. 2003).

4 LePage's Inc. v. 3M Co., 324 F.3d 141, 145 (3d Cir. 2003).

5 United States v. AMR Corp., 335 F.3d 1109, 1115 (10th Cir. 2003).

6 *See, e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 n.1 (1993).

7 The treatment of prices above average variable cost, but below average total cost varies greatly. In the Sixth and Ninth Circuits, the plaintiff has the burden of proving such prices are predatory, in the Eighth Circuit such prices are presumptively illegal, in the Tenth Circuit such prices are presumptively lawful absent other evidence of predation, and in the Eleventh Circuit prices above average variable cost create circumstantial evidence of predatory intent. In the Third, Fourth, Seventh and the District of Columbia Circuits, there is no established rule. *See* R. O. Zerbe, Jr., & M. T. Mumford, *Does Predatory Pricing Exist? Economic Theory and the Courts after* Brooke Group, 41 ANTITRUST BULL. 949, 949 n.4 (1996).

8 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

9 Cargill v. Monfort, 479 U.S. 104 (1986).

10 Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986).

11 *Brooke Group*, 509 U.S. at 223.

will briefly discuss the economics of predatory pricing and will focus on how the developing case law in the Ninth Circuit on the measurement of costs potentially leads to improper decisions from an economic perspective. We use *Thales v. Matsushita* as a case study.[12] It is our understanding that the other circuits have not taken up the issues raised here.

As a matter of economics, predatory pricing is a particular type of strategic behavior. Pricing is considered predatory when it is below the short-run profit maximizing price, and it is designed to influence a rival's behavior.[13] In the extreme, the rival is induced to leave the market, or a potential entrant is discouraged from entering. Less extreme outcomes include less aggressive competition, higher costs for the rival, or a reduction in innovation. The predator expects to recover its costs from this strategy by earning more in the future because of less vigorous rivals, or perhaps no rivals at all.

While the definition of predatory pricing is straightforward, one practical difficulty lies in determining what the short-run profit maximizing price would be absent predatory pricing. Typically, the short-run profit maximizing price can be defined relative to some benchmark of cost (e.g., marginal cost, average variable cost, average total cost). Unfortunately, the calculations of these various cost measures are typically not straightforward.

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[12] Thales Avionics, Inc. v. Matsushita Avionics Sys. Corp., Case No. SA CV 04-424-JVS (MLGx) (C.D. Cal. June 7, 2005).

[13] For a statement of the strategic nature of predation, see William S. Comanor & H.E. Frech III, *Predatory Pricing and the Meaning of Intent*, 38 ANTITRUST BULL. 294–95 (1993) and DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 352–53 (4th ed. 2005). For a more detailed analysis, see Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 223 (2000), Zerbe & Mumford, *supra* note 7, at 4. See also Kenneth G. Elzinga & David E. Mills, *Predatory Pricing and Strategic Theory*, 89 GEO. L.J. 2475 (2001) and Patrick Bolton, Joseph F. Brodley, & Michael H. Riordan, *Predatory Pricing: Response to Critique and Further Elaboration*, 89 GEO. L.J. 2495 (2001). For an excellent perspective on the changing view of predation in the economic literature and how that relates to issues of judicial economy and administratability, see Bruce H. Kobayashi, *The Law and Economics of Predatory Pricing* (George Mason Univ. Law & Econ. Research Paper Series No. 08-41, Nov. 2008).

A. The Areeda-Turner test

The modern preeminence of costs in predatory pricing analysis dates from a 1975 article by Phillip Areeda and Donald Turner. They wanted to avoid too easily condemning low prices as predatory and deterring aggressive price cutting. So Areeda and Turner suggested a simple cost-based test: prices below marginal costs would be presumed to be predatory.[14] Areeda and Turner were aware that this test did not exactly fit the economic definition of predation, but they thought that the test would be administrable and would avoid chilling competition.[15] Areeda and Turner reasoned that a firm would not set price this low, incurring short-term losses, unless it had predatory intentions. Further, they suggested that marginal costs could be approximated by average variable costs.[16] Any observed pricing below that level would be presumed to be predatory. Symmetrically, any observed pricing above that level would be presumed not to be predatory. The Areeda-Turner approach was adopted by various courts in relatively short order.[17] The rule has recently been used to provide a sort of safe harbor for low, but above-marginal-cost pricing.[18]

Of course the definition of "average variable costs" is open to interpretation and depends on the economics of the relevant sales, as described above. Moreover, the Areeda-Turner metric produces only

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[14] Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Issues Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697–733 (1975). *See also* McGahee v. N. Propane Gas Co., 858 F.2d 1487, 1504 (11th Cir. 1988); Ne. Tel. Co. v. AT&T, 651 F.2d 76, 87–88 (2d Cir. 1981); Chillicothe Sand & Gravel Co. v Martin Marietta Corp., 615 F.2d 427, 432 (7th Cir. 1980); Janich Bros. v. Am. Distilling Co., 570 F.2d 848, 858 (9th Cir. 1977); Int'l Air Indus. v. Am. Excelsior Co., 517 F.2d 714, 724 (5th Cir. 1975).

[15] *See* Kobayashi, *supra* note 13, at 60 for a recent defense of this position.

[16] Areeda & Turner, *supra* note 14, at 10. *See also* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007). The *Cascade* approach is consistent with the views of Areeda and Turner. *See Cascade*, 502 F.3d at 811, 712.

[17] *See, e.g.*, LOUIS PHLIPS, COMPETITION POLICY: A GAME-THEORETIC PERSPECTIVE 231 (1995).

[18] *See Cascade*, 502 F.3d at 913, 914.

a presumption, not an outcome. Further analysis is necessary. A number of alternative methods to determining the existence of predatory pricing have been suggested as alternatives or supplements.[19]

B. Controversies

The Areeda-Turner rule has been controversial, spawning a number of competing tests. Williamson proposed an output-based rule for response to entry-raising output when faced with entry that would be considered predatory.[20] Baumol suggested that a low price that is maintained for a long period (e.g., five years) would be deemed competitive and not predatory, regardless of the price-cost margin.[21] Scherer criticized the Areeda-Turner test (and any test based on short-run price-cost margins) and suggested a full analysis which precludes a formulaic test.[22] Moreover, Scherer rejects Areeda and Turner's assertion that their test is a good rough approximation for a complex full analysis.

Though they still use the Areeda-Turner test as a hurdle, modern courts have gone beyond Areeda and Turner to analyze the economics of each particular case. This broader approach is in the spirit of Scherer's argument. For example, in order for a firm to be guilty of predation, it is necessary for the firm to be able to recoup its losses.[23] The logic behind this is simple. Predatory pricing causes

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[19] *See, e.g.*, Phlips, *supra* note 17, at 11.

[20] Oliver Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L.J. 284 (1977).

[21] William Baumol, *Quasi-Permanence of Price Reduction: A Policy for Prevention of Predatory Pricing*, 89 Yale L.J. 1 (1979).

[22] F.M. Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 Harv. L. Rev. 883 (1976). More recently, see C. Scott Hemphill, *The Role of Recoupment in Predatory Pricing Analyses*, 53 Stan. L. Rev. 1581 (2001).

[23] The necessity of recoupment would seem to have been implicit in the theory of predatory pricing. Indeed, the classic paper arguing that predatory pricing is rare argues that recoupment would be unlikely. *See* John McGee, *Predatory Price Cutting: The Standard Oil Case*, 1 J.L. & Econ. 137 (1958). The Supreme Court made the recoupment issue explicit in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). For the argument that

short-term profits to be lower than profit maximization would call for, even if prices are not below marginal costs. The lower initial profits are an investment in altering the behavior of rivals.

In order to recoup this investment, a firm must exploit or create market power such that it could charge higher prices in the future. Recoupment requires that the predatory pricing create more market power for the predator than it would have had otherwise. It also requires that entry not be so easy or quick as to undermine the predator's market power.

Another controversy concerns the role of evidence on intent. We believe that evidence on the strategic intent of the alleged predator is often helpful in distinguishing aggressive competition from predation.[24] Strategically relevant intent can sometimes be inferred from excess capacity, a history of price wars, or excessive liquidity. In this context, statements of executives or strategic planning documents can sometimes be helpful in inferring whether the observed behavior is predatory. Indeed, it often makes sense for a predator to communicate its commitment to aggressive behavior to actual and potential rivals.[25]

C. Estimating marginal costs from available data

Estimating marginal cost is a necessary first step in Areeda-Turner analysis. Unfortunately, accounting records and reports do not normally estimate or report marginal costs, and moreover the calculation of marginal costs is likely to be quite difficult. Hence, as an approximation, courts have ordinarily substituted average variable costs.[26] In concept,

this decision sharply reduced the likelihood of plaintiffs winning these predatory pricing cases, see Bolton et al., *Predatory Pricing: Strategic Theory, supra* note 13. For a detailed analysis of the law and economics of recoupment, see Hemphill, *supra* note 22, at 12.

24 *See, e.g.*, Bolton et al., *Predatory Pricing: Strategic Theory*, *supra* note 13 and Bolton et al., *Predatory Pricing: Response*, *supra* note 13.

25 *See, e.g.*, William S. Comanor & H.E. Frech III, *Strategic Behavior and Antitrust Analysis*, 74 AM. ECON. REV. 372 (1984) and Comanor & Frech, *supra* note 13.

26 *See, e.g.*, McGahee v. N. Propane Gas Co., 858 F.2d 1487, 1504 (11th Cir. 1988); Ne. Tel. Co. v. AT&T, 651 F.2d 76, 87–88 (2d Cir. 1981); Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427, 432 (7th Cir. 1980).

variable costs are well-defined as the costs that vary with output. But, here again, this cost concept does not directly appear in accounting records and consequently the analyst must choose which accounting costs to include in full or in part. For example, even though several types of bread may be produced on the same baking and processing line in the same plant, the building lease costs or the oven costs are not likely to be directly attached to each particular bread type in the baker's accounting records.

Costs listed on a standard income statement as cost of goods sold (sometimes called product costs) can often, as a reasonable approximation, be taken to be variable.[27] However, there are additional costs, sometimes called operating costs or sales, general and administrative (SG&A) or overhead costs, that should be considered in marginal costs. We will ordinarily refer to these as overhead costs. While these overhead costs are often called fixed costs on income statements, this is usually a misnomer. These costs generally vary to some extent with output, so a portion of these costs should be included as variable costs.[28] In other words, it is not correct to simply assume that all costs labeled as fixed or overhead in accounting statements are fixed in the economic sense. A formalistic approach will not work. Economic realities matter, not accounting labels.

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[27] But note that cost of goods sold includes fixed manufacturing costs. Thus, the cost of goods sold is not quite a correctly defined lower bound on variable costs. *See* MICHAEL MAHER, COST ACCOUNTING: CREATING VALUE FOR MANAGEMENT 44–45 (1997). Interestingly, cost of goods sold was not a reasonable first approximation to variable costs in Matsushita's accounts. All labor, even including direct labor, was labeled by Matsushita as fixed overhead in its accounting records and statements.

[28] In this article, we set aside the issue of the relevant time horizon. In a longer time horizon, more costs are variable. *See, e.g.*, Kenneth L. Danger & H.E. Frech III, *Critical Thinking about Critical Loss in Antitrust*, 46 ANTITRUST BULL. 339, 352–54 (2001) and Gregory J. Werden, *The* American Airlines *Decision: Not with a Bang but with a Whimper* 5–10 (Dep't of Justice Economic Analysis Group, Discussion Paper No. EAG 03-8 (revised) Sept. 2003). For an argument that, for computer software, the time horizon should be longer than the immediate short run, see Bolton et al., *Predatory Pricing: Strategic Theory*, *supra* note 13. Their concept was followed in *United States v. Microsoft*, 87 F. Supp. 2d 30 (D.D.C. 2000), where all parties agreed that the short-run marginal cost for producing an operating system (or any major piece of software)

Moreover, certain sales may be tied to additional costs that also warrant inclusion. In the in-flight entertainment (IFE) industry, for instance, the successful sale of an IFE system often requires that the supplier have pre-established maintenance and service centers located around the world. It would be necessary to include the variable component of the costs of these centers in the determination of relevant costs for a predatory pricing analysis.[29]

The following single-product example is illustrative of the necessity of allocating some portion of overhead costs to variable costs. Assume that the cost of goods sold for a widget is $10. Further assume that overhead costs of $4,000 per year are necessary to keep the widget factory running (e.g., rent, capital equipment lease costs, management costs, unallocated utilities) at an expected output of 1000 units per month. Suppose that if the firm fully adjusts to a higher output of 1100 units these overhead costs rise to $4300. Therefore, the average variable cost of expanding output is $13 per unit. (The average total cost is $13.90 per unit.) Even for single-product firms, the extent to which these overhead costs vary with output is not known with certainty and must be estimated, using some combination of expertise and experience and sometimes statistical analysis.[30]

The analysis is further complicated for multiple-product firms. Often, some overhead costs are related to the volume produced of multiple products. For these costs (often called common costs), there is the additional issue of allocating costs among products. Unfortunately, this multiple-product situation is the rule, not the exception. The allocation of variable overhead cost across products is the key issue that determined the *Thales* ruling.[31]

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was near zero and that was not an appropriate cost basis on which to determine predatory prices. In fact the question of the correct time horizon was so thorny that the whole issue of predatory pricing (particularly selling Internet Explorer for a zero price) was dropped. *See* Franklin M. Fisher & Daniel L. Rubinfeld, United States v. Microsoft*: An Economic Analysis*, 46 ANTITRUST BULL. 1 (2001).

[29] An alternative to adjusting cost up would be to adjust the price down because of the related service.

[30] *See* MAHER, *supra* note 27, at 71–72.

[31] See, for example, Louis Kaplow and Carl Shapiro, *Antitrust*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 1073, 1194–1203 (A. Mitchell Polinsky &

A special case of the multiple-products problem arises if costs of services essential to making the sale are borne by the firm but are not directly tied to the product. For example, suppose that in order to sell widgets the firm must provide mobile widget servicing trucks to repair broken widgets. These costs, although not ordinarily appearing on the separate accounting statements for widgets, must be allocated, in part, to the widget sales.

The purpose of this article is to analyze: (1) the interpretation of the Ninth Circuit in *Marsann Co. v. Brammall, Inc.* and its progeny, *William Inglis & Sons Baking Co. v. Continental Baking Co., Inc.* with respect to cost allocation; and (2) the economic and legal implications of those rulings on *Thales*.[32]

II. THE DEVELOPMENT OF PREDATORY PRICING LAW IN THE NINTH CIRCUIT WITH RESPECT TO PRICING VERSUS COSTS

The Ninth Circuit's modern history on analyzing pricing relative to costs in a predatory pricing context dates to at least 1976 when Hanson, an operator of gas/service stations alleged that Shell Oil Co. had engaged in a price war in an effort to drive independent dealers out of the market. In *Hanson v. Shell Oil Co.*,[33] the court indicated that "proof of pricing below marginal or average variable cost [was a] prerequisite to a prima facie showing of an attempt to monopolize." The court also indicated that prices above marginal or average

Steven Shavell, eds. 2007) for a general discussion of the allocation of costs in an antitrust predatory pricing context. A similar issue arises in the allocation of common costs among multiple products in regulated industries. In the regulatory context, the policy focus is different—setting prices to avoid regulatory cross-subsidization. Further, in this context, common costs are ordinarily taken to be fixed with respect to output of any of the products. *See, e.g.*, Gerald R. Faulhaver, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966 (1975).

32 Marsann Co. v. Brammall, Inc., 788 F.2d 611, 612 (9th Cir. 1986); William Inglis & Sons Baking Co. v. Cont'l Baking Co., Inc., 942 F.2d 1332 (9th Cir. 1991). Note that in *Marsann*, as in *Thales v. Matsushita*, the predatory sales were alleged to have been made only to select customers.

33 Hanson v. Shell Oil Co., 541 F.2d 1352, 1359 n.6 (9th Cir. 1976).

variable cost might, under certain circumstances, be found predatory. In *Hanson* the court explicitly denied that prices below marginal or average variable cost were per se unlawful stating:

> While proof of pricing below marginal or average variable cost is prerequisite to a prima facie showing of an attempt to monopolize, such a showing, if made, would not show a *per se* violation. There may be non-predatory and acceptable business reasons for a firm engaging in such pricing. Plaintiff's showing of below-cost pricing merely clears the first hurdle and raises the question of justification.[34]

The next relevant decision occurs in 1977, and derives from a matter in which a liquor distributor, Janich Brothers, claimed that American Distilling Co., through its pricing policies, had attempted to monopolize the sale of private label gin and vodka in California and claimed that American had sold gin and vodka of like grade and quality at discriminatory prices. In *Janich Bros. v. American Distilling Co.*,[35] the court stated that "an across-the-board price set at or above marginal cost should not ordinarily form the basis for an antitrust violation."

Consistent with these earlier decisions, in 1979, the Ninth Circuit ruled in *California Computer Products v. IBM* that "price reductions up to the point of marginal cost are consistent with competition on the merits."[36] In this matter, IBM had repackaged and reintroduced several older products at new lower prices. California Computer Products, Inc. asserted that these lower prices were predatory. The district court had concluded that IBM expected the repackaged products to earn "substantial profits" and concluded that IBM's pricing policy was legal since the challenged prices were in fact above IBM's average cost. The Ninth Circuit affirmed with regard to this aspect of the case.

The pricing relative to cost issue was next addressed in 1981, in *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, where the court ruled that a plaintiff establishes a prima facie case of predatory pricing when it proves the defendant's prices were below "average variable cost":

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[34] *Id.*

[35] Janich Bros. v. Am. Distilling Co., 570 F.2d 848 (9th Cir. 1977).

[36] Cal. Computer Prods. v. IBM, 613 F.2d 727 (9th Cir. 1979).

> Although pricing below average total cost and above average variable cost is not inherently predatory, it does not follow however, that such prices are never predatory. Predation exists when the justification of these prices is based, not on their effectiveness in minimizing losses, but on their tendency to eliminate rivals and create a market structure enabling the seller to recoup his losses. This is the ultimate standard, and not rigid adherence to a particular cost-based rule, that must govern our analysis of alleged predatory pricing.[37]

In a slight refinement, in 1983, the court ruled in *Transamerica Computer v. IBM*[38] that even prices above average total cost may be deemed predatory upon clear and convincing proof of predatory intent. Transamerica was in effect a provider of computer peripheral devices who alleged that IBM had responded to this competition by engaging in pricing behavior (among other actions) designed to drive providers of compatible peripherals from the market.

In 1984, in *Airweld, Inc. v. Airco, Inc.*,[39] the Ninth Circuit held that the circuit had "approved cost-based methods of determining when a price is predatory" but that simply pricing below average cost was not sufficient to establish a claim of attempted monopolization. The court went on to state:

> If the plaintiff proves the prices charged by the defendant were below marginal cost or average variable cost, a prima facie case is made and the burden shifts to the defendant to show "that the prices were justified without regard to any anticipated destructive effect they might have on competitors." If the price is above average variable cost, but below average total cost, the burden remains on the plaintiff to otherwise show the predatory nature of the pricing. Id. at 1036. This can be done if the evidence shows "that the defendant sacrificed greater profits or incurred greater losses than necessary in order to eliminate the plaintiff." Last, above average total cost pricing will sustain a monopolization claim only if the plaintiff offers "clear and convincing evidence . . . that the defendant's pricing policy was predatory."[40]

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[37] William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., 668 F.2d 1014 (9th Cir. 1981). Note that this ruling incorporated the concept that the pricing scheme had to be conducted under the express intent to eliminate rivals and allow for subsequent recoupment of the costs of the scheme.

[38] Transamerica Computer v. IBM, 698 F.2d 1377 (9th Cir. 1983).

[39] Airweld, Inc. v. Airco, Inc., 742 F.2d 1184, 1193 (9th Cir. 1984).

[40] *Id.* at 1190 (citations omitted).

The court ultimately stated "below average total cost pricing, without more, is not the kind of conduct that will support a finding of attempted monopolization by a firm without market power."[41]

From 1986 to 1991, the Ninth Circuit issued its rulings in *Marsann Co. v. Brammall, Inc.*,[42] and *William Inglis & Sons Baking Co. v. Continental Baking Co., Inc.*[43] Note that *Inglis* actually predates *Marsann* but the relevant predatory pricing claims in *Inglis* were ultimately decided subsequent to, and in reliance on, *Marsann*.[44] While the underlying economic analyses in the *Marsann* and *Inglis* decisions are

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[41] *Id.*

[42] Marsann Co. v. Brammall, Inc., 788 F.2d 611 (9th Cir. 1986).

[43] William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., 942 F.2d 1332 (9th Cir. 1991).

[44] The timing of *Inglis* is somewhat complex as *Inglis* started before *Marsann*, but the key decision on cost measurement follows *Marsann*. The chronology is as follows: Inglis was a baking company in the San Joaquin Valley, selling bread in the San Francisco Bay Area and neighboring areas. In 1971, Inglis and several other bakers brought an action against competing wholesale bakers alleging antitrust violations in the Northern California, Southern California and the Northwest markets. Trial for the Northern California market commenced in March 1978. The jury returned for Inglis. Defendant Continental then moved for a judgment notwithstanding the verdict (JNOV) and for a new trial. The district court granted a JNOV and, in the alternative, a new trial on the federal Sherman Act and Robinson-Patman Act claims and a new trial on the state claims. *See* William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., Inc., 461 F. Supp. 410 (N.D. Cal. 1978). Inglis appealed to the Ninth Circuit, which reversed the district court's grant of JNOV for Continental and affirmed the grant of a new trial. *See* William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., Inc., 668 F.2d 1014 (9th Cir. 1981). The entire case was tried a second time. The jury again returned for Inglis. After this second full trial, the district court denied Continental's motions for JNOV or a new trial. Continental then appealed a second time to the Ninth Circuit. It was unsuccessful. The Ninth Circuit affirmed on the predatory pricing issues. *See Inglis*, 942 F.2d 1332. This decision contains the key holding on the measurement of costs. Two subsequent related decisions are essentially concerned with Inglis's application for attorneys' fees. *See* William Inglis & Sons Baking Co. v. Cont'l Baking Co., Inc., No. C-71-1906-JPV, 1993 U.S. Dist. LEXIS 17496 (N.D. Cal. 1993) and William Inglis & Sons Baking Co. v. Cont'l Baking Co., Inc., No. 93-16648, 1996 U.S. App. LEXIS 9769 (9th Cir. Apr. 15, 1996).

in large part related to a price cost test and the allocation of costs, they are somewhat cryptic. The *Thales* decision lays these decisions out quite thoroughly and will be described in detail below.

In 1993, in reliance on *Brooke Group* (which was decided by the Supreme Court in 1993), the Ninth Circuit ruled in *Vollrath Co. v. Sammi Corp.*,[45] that for a price to be predatory it must be "below an appropriate measure of . . . costs." Vollrath was an importer of stainless steel steamers and mixing bowls and had alleged that Sammi (through its subsidiary Ken Carter Industries) had engaged in a predatory pricing scheme related to these products. In this case, the court determined that average variable cost was the appropriate measure but did not establish this measure to the exclusion of other measures of cost.

In 1998, in *Rebel Oil Co. v. Atlantic Richfield Co.*, the Ninth Circuit again used pricing below average variable cost as the standard to show predatory pricing but did not do so to the exclusion of other measures.[46] Rebel Oil had alleged that Atlantic had engaged in predatory pricing between 1985 and 1989, selling self-serve, cash-only gasoline below marginal cost.

III. A DISCUSSION OF *MARSANN* AND *INGLIS*

As previously noted, the Supreme Court has declined to establish firm guidelines regarding the appropriate measure for determining when a price is below cost. In *Marsann*, the Ninth Circuit held that average variable cost "must be determined from costs *uniquely incurred* in the production of the particular items purchased at the allegedly predatory price."[47] The "product" here was actually a service—straightening rolls of sheet steel for a U.S. Steel plant in Pittsburg, California:

> In this case, we must decide what is a plaintiff's burden of proof for establishing the element of predation in a predatory pricing claim when the alleged predatory price is afforded only to a select customer. The

[45] Vollrath Co. v. Sammi Corp., 9 F.3d 1455, 1482 (9th Cir. 1993).

[46] Rebel Oil Co., Inc. v. Atl. Richfield Co., 146 F.3d 1088, 1095–96 (9th Cir. 1998).

[47] Marsann Co. v. Brammall, Inc., 788 F.2d 611, 612 (9th Cir. 1986).

> principal question presented is whether the average variable cost of a product, the standard against which a price is compared to establish predation, must be determined from costs uniquely incurred in the production of the particular items purchased at the allegedly predatory price, or from costs associated with the production of the total output of the product. We hold that the relevant costs are the former, viz. those uniquely incurred to produce the items sold at the challenged price.[48]

The court further held that plaintiffs' expert incorrectly "assumed that the variable costs attributable to each unit of production were the same without regard to the particular circumstances under which that unit of production took place."[49] And finally, the court held that plaintiffs failed the legal requirement that only "uniquely incurred" costs be utilized despite plaintiff's claim that the "cost figures per job would be impossible to ascertain because of the nature of [defendant's] accounting system."[50] In effect, *Marsann* held that costs could not be allocated across products; the accounting distinctions made by the defendants controlled.

The logic (and specific language) used in *Marsann* was carried over into *Inglis*, where the Court of Appeals for the Ninth Circuit held that plaintiff's expert incorrectly allocated marketing expenses uniformly across branded and store-brand bread:

> Inglis' principal evidence of intent was also the centerpiece of its entire case, a study prepared by the accounting firm of Ernst & Whinney ("E&W") that compared Continental's price for private label bread with different measures of Continental's cost for producing (we mean "production costs" to include expenses for distribution and marketing and any other expenses required to bring the bread to market) that bread. E&W calculated one measure of cost by (i) identifying the expenses that varied with Continental's total output, (ii) assigning to private label bread a percentage of each of those expenses, the percentage corresponding to private label bread's share of total Continental output, and (iii) dividing the amount resulting from step (ii) by the number of loaves of private label bread sold by Continental. (Inglis and E&W referred to this measure as the "average variable cost" of Continental's private label bread.) The study showed that, between 1970 and 1976, Continental repeatedly sold private label bread at prices that were below this measure

48 *Id.* at 611.

49 *Id.* at 613.

50 *Id.* at 614.

> of cost. Contrary to Inglis' contentions at trial and on appeal, this data could not serve as sufficient evidence of intent.
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> In order for such a price/cost comparison to support a finding of specific intent to monopolize, the cost measure would have had to include only expenses that were "uniquely incurred" in the production of private label bread. See *Marsann Co. v. Brammall, Inc*., 788 F.2d 611, 612, 613 (9th Cir. 1986). By a "uniquely incurred" expense, we mean one that Continental would not have incurred had it not produced private label bread. See *id.* at 613. The methodology of the E&W study, however, was to include expenses that Continental may have incurred regardless of its private label bread production. Inglis' cost expert, who supervised the study, testified at trial that he included in private label cost a portion of some expenses, such as those for heating, telephone, supervisors, display space, sanitation labor and supplies, even though these expenses may have been exactly the same had Continental produced no private label bread. In this way, the study failed to identify the unique cost of producing private label bread, and consequently failed to show that Continental's prices were below that cost. This flaw rendered the accounting study insufficient evidence of intent to monopolize.[51]

It should be noted that Continental's accounting system did not allocate these expenses to any particular type of bread, a not uncommon practice.[52] Nevertheless, and we agree, the court concluded that an equal allocation overstates costs for store-brand bread, since, for example, Continental would not need to spend very much on marketing it. The expert in *Inglis* might have been better served by allocating marketing expenses in some economically reasonable manner such as revenue or profit or perhaps by allocating all the marketing costs to branded bread.

It is useful here to distinguish *Inglis* from *Marsann*. It is our opinion that in *Inglis*, the problem is not that the expert used judgment to allocate overhead to the two different types of bread, but that he did it in a facially inaccurate and biased way. That is, he assigned marketing costs to a product for which the bakery obviously incurred little or no marketing costs—store-brand bread. Indeed, the lack of spending on

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[51] William Inglis & Sons Baking Co. v. Cont'l Baking Co., Inc., 942 F.2d 1332 (9th Cir. 1991).

[52] Cost accountants argue that crude allocations may be economically rational. More accurate information may not be worth the extra cost. *See* MAHER, *supra* note 27, at 71–72 .

marketing is one of the reasons that store-brand goods are generally sold at lower prices, both wholesale and retail. Even worse, the expert could have avoided this problem by simply not allocating any marketing costs to the store-brand bread. Of course, this reduces the estimate of marginal cost for store-brand bread, making a finding that price was below marginal cost less likely. The allocation of costs by the *Inglis* expert was clearly biased in favor of the plaintiff.

Marsann is quite different and the decision is more difficult to justify on economic grounds. In *Marsann*, the expert performed an analysis of accounting data, analytically separating fixed from variable costs. But that data did not distinguish among the different plants, and indeed, the accounting system did not provide enough information to so distinguish. The expert in *Marsann*, then, simply allocated the variable costs proportionally to output. In accounting jargon, output was considered the "cost driver." This is a reasonable and common approach in cost accounting and, as discussed above, something like this is ordinarily necessary for allocating overhead costs.[53] Other methods for allocation of costs could include: labor, square footage, or machine time. It should be noted that in concept, these are closely related to allocation by output.[54] Thus, *Marsann* is more difficult to make sense of than *Inglis*.

These two cases were relied upon to a large degree in *Thales* where the court effectively interpreted "uniquely incurred" to preclude the allocation of costs based on the usual cost accounting approaches.

IV. *THALES v. MATSUSHITA*

A. Brief description of the in-flight entertainment industry

The first use of IFE occurred in the early 1960s with films projected on a single screen in the cabin. Later, the IFE industry developed in-seat

[53] *See, e.g.*, Charles T. Horngren & Gary L. Sundem, Introduction to Management Accounting 9 (2003) and Malcolm E. White, *Middle City—Online Accounting Tutorial*, ch. 17, at 3 (Sept. 21, 2007), http://www.middlecity.com/ch17.shtml.

[54] The most commonly used cost driver in Japanese cost accounting is labor hours. *See* Takeo Yoshicawa, *Cost Accounting, Standard and Cost Accounting Systems in Japan*, 11 Accounting, Business & Financial History 269, 272–73 (2001).

audio, broadcasting multiple channels of audio to each seat. In 1988, video was added. As time went on, the systems became more sophisticated, allowing passengers to play video games or select on-demand video.[55]

IFE systems combine equipment and software to provide power, connectivity, audio, video, telephony, and games to passengers. An IFE system is usually sold as a complete "ship set" which refers to the head-end players (e.g., a computer server) combined with the seat-end equipment (e.g., a screen).

Moreover, IFE systems require significant servicing and maintenance in various locations around the world. For example, Thales operates a maintenance and support operation called Aerospace Services Worldwide.[56] Much of the maintenance is bundled with the products through warranties and is not separately priced. Therefore, some of the cost associated with service is a cost of an IFE system sale. Unfortunately, identifying these costs is decidedly difficult. For example, Thales sells IFE systems, avionics equipment, and other electronic systems. All of these systems are serviced at the same centers. Moreover, as commercial aircraft are often sold from carrier to carrier and moved from region to region, it is impossible to predict which IFE systems will be serviced where.

At the time of *Thales v. Matsushita,* there were only three major manufacturers of IFE systems: Thales, Matsushita, and Rockwell Collins, Inc. (Rockwell). Several other companies, including Delta Beta, General Dynamics and Ibyses International, offered IFE systems but their sales were very minor and accounted for less than five percent of the industry in total. One additional company, LiveTV LLC, sold a system limited to broadcast television within the continental United States and Canada. There were also a number of companies that sold IFE-related equipment. Moreover, Rockwell had decided not to design products for new model aircraft and, therefore, could be considered as

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[55] *See, e.g.*, World Airline Ent. Ass'n, *Historical Firsts* (Dec. 2, 2005), http://74.200.95.204/industry_info/about_ife_industry/past.asp.

[56] Aerospace Services Worldwide, http://www.thalesgroup.com/assets/0/93/238/30fb7287-239a-4f7c-8ae6-2d94e6b24a05.pdf.

slowly exiting.[57] As a result, looking forward from 2006, the industry was essentially down to two major systems manufacturers.

B. Thales Avionics

Thales entered the IFE industry when it acquired Sextant In-Flight Systems in 1999.[58] Since entering the market, Thales developed new products and by 2006 was marketing a broad series of systems ranging from the minimal (in-seat power) to highly capable advanced systems (e.g., digital video and audio on-demand using a wireless network). Until 2006, Thales's line of products was less complete than Matsushita's.

C. Matsushita

Matsushita is the largest supplier of IFE equipment, producing a full line of systems. Thales and Matsushita are the only firms that produce systems for the new generation of Airbus A380 and Boeing 787 aircraft. While the determination as to what constitutes a relevant market for antitrust purposes was disputed by the parties in *Thales v. Matsushita*, a precise definition is not central to the court's decision with respect to cost estimation.[59]

D. Thales v. Matsushita—the litigation

On April 15, 2004, Thales filed suit in the U. S. District Court for the Central District of California, against Matsushita (MAS), which

[57] While Rockwell had been a relatively large supplier in the past, it is believed in the industry that it is reducing efforts in IFE. Rockwell has not attempted to develop a system for the next generation Airbus A380 or the Boeing 787.

[58] *See* Lori Kranz, *Thales: A Company with Deep Roots and Promise for the Future in IFE*, AVION, Third Quarter 2006, at 58, 59. Note that Thales was known at that time as Thomson-CSF.

[59] Matsushita alleged that the relevant product market was broad, comprised of (at a minimum): in-seat audio/video systems; overhead audio/video systems; portable audio/video systems; satellite television systems; in-seat audio only; and even passengers supplying their own personal audio or video. Thales argued for a definition that was narrower and consisted of just in-seat audio/video systems. The parties agreed that the relevant geographic market was worldwide.

was subsequently renamed Panasonic Avionics Corporation (PAC). The suit was ultimately amended to include parent company Matsushita Electronics Inc. (MEI). For simplicity, we refer to these entities collectively as "Matsushita." The suit alleged that Matsushita attempted to monopolize the IFE marketplace through predatory pricing with the intent of causing Thales and others to be driven from the market or marginalized.

The key allegations were stated in the complaint:

> This action relates to MEI/MAS' monopolization and attempted monopolization of in-flight entertainment ("IFE") systems manufactured for installation into new and existing airplanes belonging to commercial airlines doing business in California and around the world. MEI/MAS has attempted to monopolize and has monopolized the IFE market by pricing its systems below average variable cost and by other acts of monopolization as described herein.[60]

Thales asserted four causes of action: (1) monopolization under section 2 of the Sherman Act; (2) attempted monopolization under the Sherman Act; (3) unlawful pricing under the California Cartwright Act; and (4) unfair competition under section 17200 of the California Business & Professions Code.

The Court indicated in its preliminary rulings that Thales had adequately demonstrated that Matsushita would have market power and the ability to charge monopolistic prices were Thales forced to exit the market. Reversing its preliminary position, the Court ultimately found that Thales did not meet its burden in showing actual predatory pricing because part of the analysis of Thales's accounting expert was judged inadmissible as a matter of law. Summary judgment was therefore granted on behalf of Matsushita.[61]

In order to provide a basic factual background for the analysis of the court's decision on cost estimation, the fundamental arguments of the case are summarized in brief.

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[60] Third Amended Complaint Jury Trial Demand at ¶ 2, Thales Avionics, Inc. v. Matsushita Avionics Sys. Corp., No. SA CV 04-424-JVS (MLGx) (C.D. Cal. June 7, 2005).

[61] Order Granting Defendant Panasonic Avionics Corp.'s Motion for Summary Judgment, *Thales v. Matsushita*, No. SACV 04-454 JVS(MLGx) (C.D. Cal. Mar. 30, 2006). *See also Antitrust Win for Panasonic and Matsushita*, 4 Dewey Ballantine LLP Litigation 1, 9–11 (Spr. 2007) (on file with authors).

First, Thales alleged that if it were forced from the market, Matsushita would then have market power in in-seat audio/video systems and would therefore be able to recoup at the expense of consumers. Matsushita countered that even if Thales were to exit the market, Matsushita would not capture market power since its ability to increase prices was constrained by the sellers of the other types of products (e.g., overhead systems).

Second, Thales alleged that Matsushita's selective predatory pricing strategy had prevented Thales from obtaining "launch" and "reference" customers. Thales maintained that it is generally important to establish one's IFE system as acceptable to the industry. This is accomplished by securing: (1) a launch customer who can demonstrate the viability of the system under live conditions[62]; and (2) a reference customer (generally accepted in the IFE industry to be an upper echelon airline such as Emirates, JAL or Lufthansa) that other airlines can refer to.[63] Once launch and reference customers are obtained, sales to other customers are easier to achieve. In short, Thales alleged that Matsushita could successfully implement a predatory pricing scheme by targeting just the most important buyers. Thales alleged below cost pricing on some of these important sales. In the event, Thales was not, in fact, driven from the market. Instead, Thales argued that the introduction of its new products was substantially delayed.

In its key response, Matsushita alleged that there was no evidence of predatory pricing on its part for those targeted programs (or other programs for that matter) and that Thales's determination of below-cost pricing on Matsushita's part was flawed and legally inadmissible.

[62] *See* Order Granting Defendant Panasonic Avionics Corp.'s Motion for Summary Judgment at 11, *Thales v. Matsushita,* No. SACV 04-454 JVS(MLGx) (C.D. Cal. Mar. 30, 2006).

[63] The economic rationale behind a reference customer is quite similar to that of the launch customer. Many airlines do not have the ability or willingness to independently evaluate an IFE system. As such they prefer to let a larger airline perform the due diligence and evaluation and then free ride on those efforts. For example, if Emirates purchases a Thales system, then smaller airlines can feel comfortable purchasing Thales systems as well.

V. WHAT THE COURT HELD IN *THALES v. MATSUSHITA*

In its central argument denying below-cost pricing, Matsushita relied in large part on *Marsann* and *Inglis* and claimed that Thales had incorrectly allocated costs for Matsushita's overhead, and particularly costs for Matsushita's worldwide support network, to all program bids. This would result in the allocation of costs incurred at a Matsushita service facility whether or not the IFE system in question was or would ever be serviced at that particular location.[64]

The court ultimately agreed that Thales failed to demonstrate adequately the existence of below-cost pricing and concluded that, having failed in this regard, "Thales is unable to offer sufficient evidence of predatory conduct to support its Sherman Act claims."[65] Therefore, the Court granted the motion for summary judgment for the defendant Matsushita, in spite of some findings that supported aspects of Thales's arguments.

A. The court agreed with Thales on some issues

With respect to whether pricing below average total cost was predatory, the court noted that while each of the cases cited by Matsushita used incremental cost as the standard against which to measure allegedly predatory pricing, the cases do not stand for the proposition that incremental cost was the only standard.[66] The court gave two reasons for this decision.

First, the Court cited *Brooke Group*,[67] in which the Supreme Court explicitly declined to resolve the conflicts over cost measures that

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64 In a related argument, Matsushita alleged that the case law does not support a finding of predatory pricing when prices are found to be below average total cost, but above average variable cost. In support, Matsushita cited *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007); *Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 146 F.3d 1088, 1095–96 (9th Cir. 1998); *Vollrath Co. v Sammi Corp.*, 9 F.3d 1455, 1460 (9th Cir. 1993); and *Marsann Co. v. Brammal, Inc.*, 788 F.2d 611, 613 (9th Cir. 1986).

65 Order Granting Summary Judgment, *supra* note 62, at 3.

66 *Id.* at 7.

67 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

existed in the lower courts. Second, the court noted that recent Ninth Circuit cases don't state a more definitive rule either.[68] The court went on to explain the role of the measure of costs in shifting the burden of proof. If the prices are below average total cost but above average variable cost, the plaintiff bears the burden of showing that the prices were predatory. If the prices are below average variable cost, that constitutes a prima facie case of predatory pricing, and the burden shifts to the defendant.[69] Note that this is a softer application of the Areeda-Turner test than the authors originally suggested.

In the context of the present case, the court ruled that Thales had met this particular burden sufficiently well to survive a motion for summary judgment, stating that "[t]hrough [Thales's expert], Thales offers evidence of the unique nature of the market, which suggests an anticompetitive reason to offer prices above [average variable cost] but below [average total cost]."[70]

The court also ruled that, had Thales met its burden with respect to the allocation of costs (discussed in the following section), "Thales would have presented a rational economic theory of why Panasonic would forgo covering all of its costs on certain sales to exclude or impede Thales' entry into the market sufficient to meet its Celotex burden on this theory."[71]

As we shall see, the allocation of costs issue was the critical one, and on that issue the motion was decided against Thales.

B. *The court held that the allocation of costs was not admissible*

With respect to the proper allocation of costs, the court ultimately found that Thales's accounting expert failed to follow the conceptual

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[68] *See* Transamerica Computer v. IBM, 698 F.2d 1377 (9th Cir. 1983); Janich Bros. v. American Distilling Co., 570 F.2d 848 (9th Cir. 1977); Cal. Computer Prods. v. IBM, 613 F.2d 727 (9th Cir. 1979); Vollrath Co. v. Sammi Corp., 9 F.3d 1455 (9th Cir. 1993).

[69] Order Granting Summary Judgment, *supra* note 62, at 8.

[70] *Id.* at 8–9.

[71] *Id.* at 9 (quoting William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., 668 F.2d 1014, 1035–36 (9th Cir. 1981)).

approach apparently required in *Marsann*. Along the way, the court agreed that many of this expert's judgments were admissible. Thales's accounting expert made the judgment that many costs recorded as fixed in Matsushita's accounting system were variable to some extent. Examples included advanced engineering, quality control, repair shop, and program management. What the court held next is worth quoting at length because it is far more detailed and thorough than what can be found in *Marsann* or *Inglis*:

> The Court finds that [Thales's accounting expert] was entitled to challenge Panasonic's characterization of costs. [Thales's accounting expert] estimated that 60% of these costs were in fact variable, based on review of 2003 records. From inspection of Panasonic records, [Thales's accounting expert] concluded that fixed overhead amounted to about 15% of revenue, and hence the variable portion of fixed expenses amounted to 9% of revenue. The analysis to this point is reasonable and certainly within the gambit of a material factual dispute, but at this point the analysis falters.
>
> [Thales's accounting expert] does not tie her analysis to the specific projects which she analyzed . . . [and] similarly moved from analyzing direct and indirect labor costs on a macro basis to a uniform addition to each program of 25% of revenue to cover variable labor costs . . . . The Court believes that as an expert [Thales's expert] was entitled to make an allocation for variable labor, but consistent with the controlling case law, she was required to go farther . . . . [Thales's accounting expert's] approach to overhead and labor parallels the work by plaintiff's expert accounting firm which was rejected in *William Inglis*: E&W calculated one measure of cost by (i) identifying the expenses that varied with Continental's total output, (ii) assigning to private label bread a percentage of each of those expenses, the percentage corresponding to private label bread's share of total Continental output, and (iii) dividing the amount resulting from step (ii) by the number of loaves of private label bread sold by Continental. The study showed that, between 1970 and 1976, Continental repeatedly sold private label bread at prices that were below this measure of costs. Contrary to Inglis' contentions at trial and on appeal, this data could not serve as sufficient evidence of intent.
>
> The parallel holds true with *Marsann*. Cropper determined Brammall's [average variable cost] by studying costs of the company's entire roll-straightening division over the four-month period in which Brammall performed its work at United States Steel. He then classified costs as fixed or variable, dividing the total variable costs by output to produce the [average variable cost] figure. *In effect, he assumed that the variable costs attributable to each unit of production were the same without regard to the particular circumstances under which that unit of production took place.* Marsann

> admits that Cropper did not examine the actual costs of the United States Steel job alone.
>
> In effect [Thales's accounting expert] assumed that the variable costs attributable to each unit of production were the same without regard to the particular circumstances under which the unit of production took place. That [Thales's accounting expert] was not entitled to do.[72]

This last step (which the court ruled inadmissible) is actually a reasonable, and economically justified, cost accounting approach to allocating joint costs to specific projects. In fact, it is a necessary element in estimating marginal costs for many purposes.

VI. *MARSANN* EFFECTIVELY BARS THE ALLOCATION OF OVERHEAD COSTS

The language in *Marsann,* and its progeny *Inglis* and *Thales,* is sweeping. We read it as effectively barring the allocation of costs on any output-related basis. If we are correct, *Marsann* creates problems for antitrust and indeed for more general commercial litigation because allocation of costs to projects or products is a necessary ingredient of cost estimation.

The *Marsann* court's interpretation of "uniquely incurred costs" effectively bars the allocation of costs based on a percentage of revenue generated by a particular product or in the case of *Thales*, a particular IFE program. Furthermore, no other possible method of allocation is approved, suggesting that no allocation method is possible. Again, allocation of variable overhead costs by revenue is a reasonable basis. More strikingly, we will demonstrate that allocation by revenue is conservative from the viewpoint of a predatory pricing plaintiff.

Revenue is, of course, closely related to output. Indeed, in the simple case of constant pricing across programs, revenue is perfectly correlated with output, being simply output times a constant price. If we make the further assumption that direct costs are proportional to output, then revenue is also perfectly correlated with direct costs. On these assumptions, allocation of variable overhead by revenue is

[72] Order Granting Defendant's Motion to Exclude, Thales Avionics, Inc. v. Matsushita Avionics Sys. Corp., No. SACV 04-454-JVS(MLGx) (C.D. Cal. Mar. 30, 2006) (citations omitted).

equivalent to allocation by direct costs or output. No wonder output and direct costs are such common bases for cost allocation in accounting. They are very similar. One might ask, why use revenue as the measure of output in this situation?

Using revenue in this situation is both simpler and more conservative than the other common bases. In the IFE industry, pricing is by program. Programs differ greatly in scale and in exactly which goods and services are provided. For example, a program might involve 2 airplanes or 120 airplanes. One might adjust output by the number of airplanes, or better, the number of seats. But that doesn't go far enough. The simplest system costs a small fraction of the high-end, high-tech versions. Revenue is a value-weighted index of output. Very large, expensive programs involve high output and high revenue.[73]

When examining an allegation of targeted predatory pricing, the simplifying assumption of constant prices across products or programs will likely be violated. The prices are likely to be lower for the sales that are alleged to be predatory. This introduces a bias in the estimation of costs, but the direction of the bias is conservative from the plaintiff's viewpoint. It leads to an understatement of the variable costs for the alleged predatory pricing. Thus, revenue, it turns out, is not merely a reasonable basis for allocating variable overhead cost. Revenue is more conservative than the other common bases for allocation and thus should be given a privileged position in predatory pricing cases—far from being explicitly excluded.

A. *A numerical example*

To see the conservative direction of the bias resulting from allocating by revenue, consider a simple example that tracks *Thales*.

[73] It is because of this necessity of averaging over heterogeneous products that revenue is an accepted measure for market share and Herfindahl-Hirschman Indexes in antitrust. *See* DEP'T OF JUSTICE & FEDERAL TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 1.41 (Apr. 1997). Revenue is commonly used to allocate costs in the newspaper industry. *See* Phillip W. McLeod & Michael W. Maher, *Analyzing Newspaper Costs in Predation Lawsuits*, NEWSPAPER RES. J., Fall 1998, at 2, http://findarticles.com/p/articles/mi_qa3677/is_199810/ai_n8817359.

There is a predatory pricing defendant who sells two programs. Program *A* is priced lower, relative to costs, than program *B*. Naturally, program *A* is the one that is alleged to be predatory. For simplicity, let us assume that the programs are identical physically and in the true marginal costs of production, sales, and service. Further, assume that direct costs are also identical across programs. These assumptions imply that allocation according to direct cost is correct.

The problem for the accounting or economic analyst is to use accounting records and reasonable analytical methods to determine whether the pricing in program *A* is below variable costs, thus meeting the Areeda-Turner test. Suppose that the accounting information system generates the following information:

PROGRAM LEVEL DATA

	Program A	*Program B*
Selling Price (Revenue)	$90	$200
Direct Cost	$65	$65

FIRM LEVEL DATA

Fixed Cost for the Firm	$25
Variable Overhead for the Firm	$100

For this example, we have finessed the problem of estimating how much of the overhead cost is variable. We assume that this has been established and that there is no dispute about the magnitude of the variable overhead cost. The remaining problem is to allocate the known variable overhead cost across programs. The defendant's accounting system admits of two possibilities for this: (1) direct cost or (2) revenue. The following notation will be used:

Variable Overhead Cost of *A* (unknown): VOC_A
Variable Overhead Cost of *B* (unknown): VOC_B
Revenue from *A* (known): R_A
Revenue from *B* (known): R_B
Direct Cost of *A* (known): DC_A
Direct Cost of *B* (known): DC_B
Total Variable Overhead Cost (known): *TVOC*
Total Revenue (known): *TR*
Total Direct Cost (known): *TDC*

If one allocates according to revenue, the variable overhead cost for each program (i.e., *A* and *B*) would be calculated by multiplying the total variable overhead cost by the ratio of the revenue of each program to total revenue. Thus, for program *A*, the variable overhead cost, expressed symbolically, is:

$$VOC_A = (TVOC)\left(\frac{R_A}{TR}\right) \tag{1}$$

Plugging in the actual values from the accounting data, the variable overhead cost for program *A* is:

$$VOC_A = (\$100)\left(\frac{90}{290}\right) = \$31 \tag{2}$$

A similar calculation from program *B* follows gives the variable overhead cost for program *B*:

$$VOC_B = (TVOC)\left(\frac{R_B}{TR}\right) \tag{3}$$

In terms of the values from the accounting data, the variable overhead cost for program *B* is:

$$VOC_B = (\$100)\left(\frac{200}{290}\right) = \$69 \tag{4}$$

If, instead, one allocates according to direct cost, the variable overhead cost would be calculated by multiplying the total variable overhead cost by a different ratio, the ratio of direct cost for program *A* to total direct cost:

$$VOC_A = (TVOC)\left(\frac{DC_A}{TDC}\right) \tag{5}$$

In term of the accounting data, the direct cost method gives variable overhead cost for program *A*:

$$VOC_A = (\$100)\left(\frac{65}{130}\right) = \$50 \tag{6}$$

And again, similarly for program *B*:

$$VOC_B = (TVOC)\left(\frac{DC_B}{TDC}\right) \tag{7}$$

In terms of the accounting data, the direct cost method gives variable overhead cost for program *B*:

$$VOC_B = (\$100)\left(\frac{65}{130}\right) = \$50 \tag{8}$$

Comparing the methods, (equation 2 versus equation 6), one can see that the revenue allocation method allocates less cost to the allegedly predatory low-price program, program *A*. This method reduces the cost, making a finding that program *A* was priced below variable cost more difficult. Thus, the revenue method is biased against the predatory pricing plaintiff. In this example, price is below variable cost using either method, but it is closer to cost using the revenue method.[74] Thus, the profits from program *A* are negative, under either allocation, but they are less negative using the revenue allocation method.

Numerically, using the revenue allocation method for program *A*, the profit from program *A* is:

$$R_A - VC = \$90 - \$65 - \$31 = -\$6 \tag{9}$$

[74] This example shows the likely case, where the ratio of revenue to direct cost for the program suspected of being predatory is substantially below that ratio for other sales. That is why these sales are suspect in the first place. At a quick look, the apparent profit from the allegedly predatory sales is lower. But the result from the example could be reversed if somehow the contrary were true (i.e., the ratio of revenue to direct cost for the suspect program was above the ratio for other sales).

Thus, revenue is estimated to be \$6 below variable cost for program *A*. The firm is losing money. Using the direct cost allocation method for program *A*:

$$R_A - VC = \$90 - \$65 - \$50 = -\$25 \tag{10}$$

Under the direct cost allocation method, revenue is estimated to be significantly further below cost, i.e., \$25 versus \$6. Actual profits on program *A* are lower than the profits calculated from the revenue allocation method.

This demonstrates the conservative nature of allocation by revenue for predatory pricing analysis. In this example, it is more conservative than the assumed truth—which would be found by allocation according to direct costs. In most predatory pricing situations, one would expect allocation by revenue to be more conservative than allocation by physical output or (closely related) direct costs. If the allegations are true, the method would ordinarily be biased against the plaintiff. There is a long-standing preference for conservative enforcement of predatory pricing law. It follows that revenue should be a privileged base for allocating cost among products for predatory pricing analysis—not a prohibited base. *Thales* seems to have it quite wrong at this crucial point.

B. *Under the* Thales *holding, prices could almost never be below cost*

If the analyst is prevented from allocating variable overhead costs in some straightforward manner, any costs that are not directly attached to output by product within a company's own financial statements are effectively excluded from the average variable cost. This exclusion might drive the estimated average variable cost down low enough that prices could not be observed below average variable cost. This would make it almost impossible to prove what has become a threshold issue for predatory pricing—a violation of the Areeda-Turner test. It seems very unlikely that the court meant to do that.

Further, a firm that might consider predatory pricing in the future could game the system to defeat a predatory pricing claim. It would simply accumulate more costs in a general overhead category and fewer costs in a direct cost category in its accounting statements.

Would-be predators could structure their accounting systems to evade liability.

C. *Applying the* Thales *holding to calculations for lost profit damages in general*

Further, the same issue of allocating overhead variable costs comes up in commercial damages calculations far beyond the confines of antitrust law. Often, the basis for damages estimation is lost profit from lost sales. This requires an estimate of marginal cost, for which average variable cost is often the proxy. Much the same as in an Areeda-Turner predatory pricing analysis, the calculation of average variable cost for damages purposes requires an adjustment of overhead to account for the variable portion and an assignment to various products in a multiproduct firm. If this allocation is not allowed by courts following the reasoning of *Thales*, there are two possible outcomes, neither of which is desirable. One possibility is for a court to rule that a reasonable estimated average variable cost cannot be established, and therefore damages cannot be calculated. Alternatively, a court could rule that estimated average variable cost cannot include allocated average variable cost. This second possibility will understate cost and, therefore, overstate damages. Neither outcome makes good economic or legal sense.

VII. CONCLUSION

It is difficult to say why the court's reasoning seems to have gone astray in *Marsann* and ultimately *Thales*. Perhaps the court was overly sensitive to the danger of a plaintiff overstating cost in an Areeda-Turner pricing analysis by loading excessive variable overhead onto the product or program in question. That sensitivity seems clearly at the heart of *Inglis*. This danger suggests care in evaluating the accounting and economic logic and data used, but it cannot support barring a necessary step in cost estimation: the allocation of variable overhead cost across products.

It seems to us that the allocation of variable overhead is an important factual issue that should be considered by the fact finder at trial. This allocation requires careful analysis by expert accountants and economists, evaluated in the structured adversarial setting of a trial. A sound judgment on the allocation of variable overhead cost is not susceptible to judicial determination at summary judgment, based on briefings, oral argument, depositions, and reports. Such an allocation is necessary to the correct application of the Areeda-Turner test. Further, the determination of a reasonable allocation is not something new and exotic for courts. Nor is this determination primarily an issue for predatory pricing or even antitrust law. Allocating variable overhead cost is an everyday issue for courts dealing with lost profits due to many causes of action, from construction delays to commercial defamation. We suggest that the reasoning used in the *Marsann* case and ultimately the *Thales* decision is faulty and will cause unnecessary problems in future cases.

The Antitrust Bulletin

Foreign Antitrust

Collective dominance and refusal to supply: Closing the gap in article 82?

BY PAOLO SICILIANI*

I. INTRODUCTION

The interplay between competition and investment is one of the most pressing economic issues debated in the public policy arena. This is particularly true in reference to electronic communications and services (ECNS) industries, where a balance needs to be reached between enforcing a level playing field and preserving minimum conditions of appropriability, in order to maintain investment incentives to venture into risky development projects, while granting that consumers share in the benefits from successful innovations.

Regulatory and antitrust authorities play a crucial role in this task, in particular, as they prevent and deter dominant firms from unduly monopolizing their markets. In this respect, European policy makers are in the process of reviewing the analytical frameworks and the rules

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AUTHOR'S NOTE: *These views are personal and should not be attributed to the Office of Fair Trading. The usual disclaimer applies. This article was complete in September 2008. On December 3, 2008, the European Commission published a guidance document concerning its enforcement priorities in applying article 82 to abusive exclusionary conduct by dominant undertakings. However, it is worth pointing out that this document was not intended to constitute a statement of law and related only to abuses committed by undertakings holding single dominance.* See *European Commission, Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treating to Abusive Exclusionary Conduct by Dominant Undertakings, 2009 O.J. (C45/7) ¶¶ 3, 4.*

that will instruct their regulatory and antitrust stances.[1] On the one hand, with the 2007 Review of the European Regulatory Framework for ECNS and the Recommendation on Relevant Markets, the EC Commission is proposing to refine EU telecom rules in order "to regulate less in some markets where competition is already effective, and regulate in a more focussed and more consistent way in markets where competition still has not yet developed."[2] On the other hand, the need to strike the balance thereof is at the core of the ongoing[3] review process of article 82 of the EC Treaty, in particular, on its application to exclusionary abuses, whereby the focus shall evolve from "fairness" to consumer welfare, thus protecting competition, and not competitors, with the ultimate aim of avoiding consumer harm.[4]

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[1] Similarly, in April 2007 the Antitrust Modernization Commission (AMC), a bipartisan commission established by the U.S. Congress in 2002 to review federal antitrust laws to determine whether they should be modernized, reached its conclusions. *See* Antitrust Modernization Comm'n, Report and Recommendations 101 (2007), *available at* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf. [hereinafter AMC Report]. However, it recommended no legislative changes to section 2 of the Sherman Act (i.e., the equivalent of article 82 of the EC Treaty), concluding that courts were generally applying appropriate standards for determining whether firms were engaging in unlawful monopolistic behavior. *Id*. at 83.

[2] Viviane Reding, Review 2006 of EU Telecom Rules: Strengthening Competition and Completing the Internal Market, Address at Annual Meeting of BITKom (June 27, 2006), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/422&format=HTML.

[3] Indeed, the possibility that this review process will ever lead to the adoption of corresponding Guidelines is a recent topic of debate. *See* Liza Lovdahl-Gormsen, *Will There be Article 82 Guidelines and What are the Implications?*, 2 Global Competition Pol'y (2008), *available at* http://www.globalcompetitionpolicy.org/index.php?&id=1015&action=907; Cani Fernandez & Albert Pereda, *Will There be Guidelines on Article 82 of the EC Treaty?*, 2 Global Competition Pol'y (2008), *available at* http://www.globalcompetitionpolicy.org/index.php?&id=1014&action=907; and Damien Gerard, *The Commission on Velvet: Why it will Probably not Issue Article 82 Guidelines Any Time Soon,* 2 Global Competition Pol'y (2008), *available at* http://www.globalcompetitionpolicy.org/index.php?&id=1026&action=907.

[4] Neelie Kroes, Preliminary Thoughts on Policy Review of Article 82, Speech at Fordham Corporate Law Inst. (Sept. 23, 2005), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML.

An archetypal issue where this balance is at the core of the controversy is mandatory upstream access to essential facilities in order to boost downstream competition.[5] In this respect, some scholars argue that European authorities have traditionally shown a "natural bias" in favor of ex post incentives to improve allocative efficiency, thus sacrificing ex ante incentives to continuously advance dynamic efficiency.[6] This bias seems to survive in the two review processes abovementioned.[7] On the one hand, to quote Commissioner Reding once again, "Europe's lesson from the liberalisation of the telecom markets is therefore: Competition has been a key driver for investment and innovation."[8] On the other hand, when defining the essential objective of article 82 of the EC Treaty in its proposal, the European Commission equates allocative efficiency to consumer welfare, rather than uniquely endorsing the "consumer harm" standard, or at least referring to both allocative and dynamic efficiency.[9]

5 *See* Ashwin van Rooijen, *The Role of Investments in Refusals to Deal*, 31 WORLD COMPETITION 1, 63 (2008), and Christian Ahlborn, Vincenzo Denicolò, Damien Geradin, & Jorge A. Padilla, DG Comp's Discussion Paper on Article 82: Implications of the Proposed Framework and Antitrust Rules for Dynamically Competitive Industries (Mar. 31, 2006), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/057.pdf. For a recent survey on the issue of essential facility, see Thomas F. Cotter, *The Essential Facility Doctrine*, *in* ANTITRUST LAW AND ECONOMICS (Keith N. Hylton ed., forthcoming).

6 *See*, *e.g.*, Damien Geradin, Refusal to Supply and Article 82 (June 14, 2006), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/geradin.pdf.

7 This bias may be traced back to the philosophical origins of the mainstream of modern welfare economics. *See* Mark Blaug, *The Fundamental Theorems of Modern Welfare Economics*, 39 HIST. POL. ECON. 2, 185 (2007). More circumscribed to the issue of the enforcement of article 82 EC, it can be framed within the ordoliberal doctrine. *See* Giorio Monti, *The Concept of Dominance in Article 82*, 2 EUR. COMPETITION J. (2006), *available at* http://ssrn.com/abstract=1118385. Moreover, from a public choice perspective, this bias may be justified in light of the greater ease of measuring the short run benefits from improved allocative efficiency than the long run uncertain benefits from dynamic efficiency. *See* Geradin, *supra* note 6.

8 Reding, *supra* note 2.

9 European Commission, DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses ¶ 54 (2005), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf [hereinafter Discussion Paper].

Among economists, the debate about the relationship between innovation, competition, and antitrust[10] & regulatory[11] policies is far from settling down. Theories of innovation make diverse predictions about the impact of competition on the innovative behavior of firms.

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[10] *See* Mark Blaug, *Is Competition Such a Good Thing? Static Efficiency versus Dynamic Efficiency*, 19 REV. INDUS. ORG. 37 (2001); Ilya R. Segal & Michael D. Whinston, *Antitrust in Innovative Industries*, 97 AM. ECON. REV. 1703 (2007); Richard J. Gilbert, *Holding Innovation to an Antitrust Standard*, 3 COMPETITION POL'Y INT'L 3 (2007); Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation* (American Antitrust Institute Working Paper No. 07-04, 2007), *available at* http://ssrn.com/abstract=1103623; Frederic M. Scherer, *Technological Innovation & Monopolization* (KSG Working Paper No. RWP07-043, 2007), *available at* http://ssrn.com/abstract=1019023; Herbert J. Hovenkamp, *Innovation and the Domain of Competition Policy* (Univ. Iowa Legal Stud. Research Paper No. 08-07, 2008), *available at* http://ssrn.com/abstract =1091488; Tim Brennan, *Should Innovation Rationalize Supra-Competitive Prices? A Skeptical Speculation* (paper presented at Pros and Cons of High Prices Seminar, Nov. 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm ?abstract_id=1030115.

[11] The relationship between regulatory unbundling (typically, of the so-called local loop in wireline access networks) and investment is a contentious one, which is beyond the scope of this article. Taking a European and evidence-based focus, among the advocates that unbundling regulation has crowded out investments in alternative infrastructure, are Walter Distaso, Paolo Lupi & Fabio Manenti, *Platform Competition and Broadband Uptake: Theory and Empirical Evidence from the European Union*, 18 INFO. ECON. & POL'Y 87 (2006); Leonard Waverman, Meloria Meschi, Benoit Reillier & Kalyan Dasgupta, *Access Regulation and Infrastructure Investment in the Telecommunications Sector: An Empirical Investigation* (LECG, 2007), *available at* http://www .etno.be/Portals/34/ETNO%20Documents/LECG_Final%20Report.pdf; and Hans W. Friederiszick, Michal Grajek & Lars Hendrick Roeller, *Analysing the Relationship between Regulation and Investment in the Telecommunications Sector* (Eur. Sch. Mgmt. & Tech. Working Paper No. 108-01, 2007), *available at* http://www.esmt.org/fm/13/WP-108-01.pdf. For an opposite view, see London Economics & PricewaterhouseCoopers, *An Assessment of the Regulatory Framework for Electronic Communications—Growth and Investment in the EU e-Communications Sector* (2006), *available at* http://ec.europa.eu/information _society/policy/ecomm/doc/library/ext_studies/assessmt_growth_invst /investment.pdf; Robert Cadman, *Regulation and Investment in European Telecom Markets* (SCP Networks, 2007), *available at* http://www.ectaportal.com /en/upload/File/Regulatory%20Scorecards/2007/Euro_investment_paper .pdf; and ORG. ECON. CO-OPERATION & DEVELOPMENT, CATCHING-UP IN BROADBAND—WHAT WILL IT TAKE? (2007), http://www.oecd.org/dataoecd/34 /34/39360525.pdf.

Models variously conclude that innovation is a decreasing,[12] increasing,[13] or initially increasing then decreasing function of the level of competition.[14] This lack of consensus further stresses the importance of reaching a balanced policy framework to guide enforcement against alleged exclusionary practices, in order to avoid discouraging beneficial innovations.[15]

Ultimately, the way the trade-off between allocative and dynamic efficiency is concretely handled is reflected in the burden of proof required to condemn an alleged anticompetitive practice.[16] In this respect, a testing ground for such a reformed approach is the area of enforcement against abuses of collective dominance. First of all, although it has been established that in principle the test of collective dominance under the European Community Merger Regulation (ECMR) is fully applicable under article 82 of the EC Treaty,[17] "[t]he

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[12] *See* Mike F. Scherer, *Research and Development Resource Allocation under Rivalry*, 81 Q.J. ECON. 359 (1967); Glenn C. Loury, *Market Structure and Innovation*, 93 Q.J. ECON. 395 (1979).

[13] *See* Tom Lee & Luis L. Wilde, *Market Structure and Innovation: A Reformulation*, 94 Q.J. ECON. 429 (1980); Jennifer F. Reinganum, *A Dynamic Game of R and D: Patent Protection and Competitive Behavior*, 50 ECONOMETRICA 671 (1982); and Philippe Aghion, Christopher Harris, Peter Howitt & John Vickers, *Competition, Imitation and Growth with Step-by-Step Innovation*, 68 REV. ECON. STUD. 467 (2001).

[14] *See* Pietro F. Peretto, *Cost Reduction, Entry and the Interdependence of Market Structure and Economic Growth*, 43 J. MONETARY ECON. 173 (1999); Toshihiko Mukoyama, *Innovation, Imitation and Growth with Cumulative Technology*, 50 J. MONETARY ECON. 361 (2003); and Philippe Aghion, Nicholas Bloom, Richard Blundell, Rachel Griffith & Peter Howitt, *Competition and Innovation: An Inverted U Relationship*, 120 Q.J. ECON. 701 (2005).

[15] Ahlborn et al., *supra* note 5, at 20.

[16] *Id*. at 27; *see* Einer R. Elhauge, *Public Hearing on Article 82, General Framework* (June 14, 2006), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/hearing.html; and Giorgio Monti, *Comments on the Article 82 Discussion Paper* 4 (2005), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/065.pdf.

[17] *See* Joined Cases C-395/96 P & C-396/96 P, Compagnie Maritime Belge Transports SA v. Comm'n, 2000 E.C.R. I-1365, at ¶ 45; Joined Cases T-191/98 & T-212/98 to T-214/98, Atlantic Container Line AB v. Comm'n, 2003 E.C.R. II-3275, at ¶¶ 652, 654; Case T-193/02, Laurent Piau v. Comm'n, 2005 E.C.R. II-00209, at ¶ 111. *See also* Discussion Paper, *supra* note 9, at ¶¶ 47, 48.

case law so far with respect to exclusionary abuse of a collective dominant position has dealt with situations where there were strong structural links between the undertakings holding the dominant position."[18] Therefore, while the legal conditions defined in *Airtours* are necessary not only in the assessment that a concentration would *create* a collective dominant position,[19] but also in the context of the assessment of its *existence*,[20] thus in principle equating the definition of collective dominance under article 82 of the EC Treaty to what economists refer to as coordinated effects through "tacit collusion,"[21] it appears that, in the absence of an overt agreement, a concerted practice,[22] or structural links,[23] there may be a problem of identifica-

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18 Discussion Paper, *supra* note 9, at ¶ 76.

19 Case T–342/99, Airtours plc v. Comm'n, 2002 E.C.R. II–2585, at ¶ 62.

20 *See* Case T-464/04, Impala v. Comm'n, 2006 E.C.R. II-2289, at ¶ 251.

21 *See* RICHARD WHISH, COMPETITION LAW 526 (5th ed., 2003) ("The judgement of the [Court of First Instance] in Airtours v. Commission is consistent with this interpretation: the essence of collective dominance is parallel behaviour within an oligopoly, that is to say tacit collusion or tacit coordination. . . .") This assimilation emerges even more clearly within the Electronic Communiations Networks and Services (ECNS) Regulatory Framework. *See* Council Directive 2002/21/EC on a Common Regulatory Framework for Electronic Communications Networks and Services, 2002 O.J. (L 108/33) recital 27 [hereinafter Framework Direcive] ("Two or more undertakings can be found to enjoy a joint dominant position not only where there exist structural or other links between them but also where the structure of the relevant market is conducive to coordinated effects, that is, it encourages parallel or aligned anti-competitive behaviour on the market.").

22 *See* JORGE A. PADILLA & ROBERT O'DONOGHUE, THE LAW AND ECONOMICS OF ARTICLE 82 EC 137 n.155 (2006).

23 *See* Int'l Bar Assoc., Comments of the International Bar Association Antitrust Committee on the Article 82 Discussion Paper ¶ 4.5.2. (2006), *available at* http://ec.europa.eu/competition/antitrust/art82/102.pdf ("We fail to understand how the market structure constraints under which oligopolists typically operate ("Oligopolzwang") can cause them to collectively hold and abuse a dominant position. . . . In the absence of any form of agreement or corporate link between the oligopolists, the Commission would seem to circumvent the limited scope of Art. 81 by applying Art. 82 to their behaviour instead.") *See also* American Bar Association, Joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law on the Article 82 Discussion Paper 9 (2006).

tion, whereby the observation of a common conduct among the alleged colluding firms could also be consistent with a situation where firms independently and rationally pursue their self-interest, without expecting to influence their competitors:

> If firms are acting in a way that takes their competitors' future actions entirely as given, and not as open to influence by the firm's own actions in the present, then the situation is not one of tacit collusion, even if (as a result of the high concentration in the market) prices are significantly above marginal cost, or if other symptoms of non-competitive behavior are present. Note that even if firms are not expecting to influence their competitors, this does not imply that they are unresponsive to market conditions. On the contrary, each firm will be taking its decisions regarding prices, output or other choice variables in a way that responds to market conditions (which themselves are the results of the decisions of other firms).[24]

This problem of inference resonates the position taken by the European Court of Justice (ECJ) as long ago as *Hoffmann-La Roche*,[25] whereby to condemn "conscious parallelism"[26] as abusive in itself would be nonsensical, as it would mandate that firms must behave *irrationally* in order to comply with the law.[27] Arguably, it ultimately depends on what

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[24] Marc Ivaldi, Bruno Jullien, Patrick Rey, Paul Seabright & Jean Tirole, *The Economics of Unilateral Effects* 4 (Final Report for the DG Competition, European Commission, 2003), *available at* http://ec.europa.eu/comm/competition/mergers/review/the_economics_of_unilateral_effects_en.pdf.

[25] Case 85/76, Hoffmann-La Roche & Co. AG v Comm'n, 1979 E.C.R. 461, at ¶ 39.

[26] The debate about the treatment of tacit collusion originated in the United States with a controversy between Judge Posner, who argued that mere tacit collusion should be viewed as a form of concerted action (thus actionable under section 1 of the Sherman Act), and Judge Turner, who argued that it would be vain to try to prevent this sort of conduct, because the remedy would require firms to act irrationally or to submit to direct price regulation. *See* Nikolai G. Levin, *The Nomos and Narrative of* Matsushita, 73 FORDHAM L. REV. 1627, 1674 (2005); Enrico A. Raffaelli, *Oligopolies and Antitrust Law*, 19 FORDHAM INT'L L.J., 915, 933 (1996). It is worth remembering that, contrary to the European system, situations of jointly held monopolies are not caught under section 2 of the Sherman Act. *See* PADILLA & DONOGHUE, *supra* note 22, at 138 n.157.

[27] WHISH, *supra* note 21, at 527 ("It might seem that this shows an inconsistency between the law under Article 82 and the ECMR: how can it be that the prospect of tacit coordination can be condemned under the Merger Regu-

is held to be an irrational conduct, as sticking to a collusive agreement is irrational in the short term, whereas it pays off in the long term.[28] However, this controversy arises primarily in the area of exploitative abuse of collective dominance, where the ability to raise prices above competitive levels (albeit not "excessively") is inherent in the nature of collective dominance, thus not ipso facto an abuse,[29] whereas exclusionary abuses aimed at maintaining or strengthening the existing collective dominant position are viewed as the most sensible rationale for enforcement of article 82 of the EC Treaty.[30]

In this respect, although the definition of significant market power (SMP), which is the central tenet of the ECNS Regulatory Framework, is firmly equated to dominance within the meaning of article 82 of the EC Treaty,[31] the trigger of the imposition of regulatory obligations dif-

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lation and yet the actuality of the same behavior cannot be condemned under Article 82? The truth is that the difference makes perfect sense: it is precisely because of the difficulty that competition law has in addressing the problem of tacit coordination when it does occur that competition authorities . . . endeavour to prevent a market structure that will be conducive to this phenomenon arising in the first place.").

[28] *See* Gregory J. Werden, *Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law with Oligopoly Theory*, 71 ANTITRUST L.J. 719 (2004); Kai-Uwe Kühn, *An Economists' Guide through the Joint Dominance Jungle* 7 (unpublished manuscript Univ. Mich., 2001), *available at* http://ssrn.com/abstract=349523.

[29] WHISH, *supra* note 21, at 527; PADILLA & DONOGHUE, *supra* note 22, at 162.

[30] WHISH, *supra* note 21, at 528; PADILLA & DONOGHUE, *supra* note 22 at 162. On the contrary, recent decisions of the U.S. Supreme Court seem to have definitely solved the so-called oligopoly problem by ruling out the unlawfulness of mere tacit collusion, even though exclusionary in nature, under section 1 of the Sherman Act. *See* Celeste K. Carruthers, Twombly *and the Evolution of Telecom Regulation*, 53 ANTITRUST BULL. 95 (2008); Matthew M. Bunda, Monsanto, Matsushita*, and "Conscious Parallelism": Towards a Judicial Resolution of the "Oligopoly Problem,"* 84 WASH. U. L.Q. 179, 198 (2006); and Levin, *supra* note 26. For a critical view, see James Brock, *Antitrust Policy and the Oligopoly Problem*, 51 ANTITRUST BULL. 227 (2006).

[31] *See* Framework Directive, *supra* note 21, art. 14(2). Moreover, this strict interpretation is maintained in the European Commission's proposal for reviewing the ECNS Regulatory Framework. *See Commission Proposal for a Directive Amending Directives 2002/21/EC on a Common Regulatory Framework for*

fers from the enforcement area of competition law.[32] Once the market has been defined and identified as susceptible to ex ante regulation, intervention is triggered by the existence of SMP,[33] rather than its abuse under article 82 of the EC Treaty or its strengthening/creation under the ECMR. However, since the *existence* of joint SMP is manifested through exclusionary abuse in the form of refusal to supply (rather than through noncompetitive prices at the retail level)—that is, the provision of wholesale access would signal the *inexistence* of a position of collective dominance at the upstream level—the difference between the two enforcement areas in formal terms does not matter in terms of substantive competitive assessment.

In this regard, when the exclusionary abuse is in the form of refusal to start supplying, the problem of identification may yet be present,[34] given that what is observed is parallel *inaction* from the alleged colluding firms.[35] Moreover, there have been some attempts to

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Electronic Communications and Services, 2002/19/EC on Access to, Interconnection of, Electronic Communications and Services, and 2002/20/EC on the Authorisation of Electronic Communications and Services ¶ 42, COM(2007) 697 final 2007/0247 (COD) (Nov. 13, 2007).

[32] Having equated SMP with dominance in this sector, the Commission's approach in the Discussion Paper was to restate the converse of that proposition: dominance means SMP for all economic sectors. However, there appear, to be a resistance to departing from the traditional characterization of dominance as "commercial power" based on the ordoliberal notion of competition as an *institution* to be protected. *See* Monti, *supra* note 7, at 12.

[33] Framework Directive, *supra* note 21, art. 15(1).

[34] *See* Monti, *supra* note 7, at 4.

[35] In this respect, the recent decision of the U.S. Supreme Court in *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007), is indicative of the widening gap between U.S. and European authorities towards exclusionary "conscious parallelism." The plaintiffs claimed that the defendants'exclusionary conduct occurred pursuant to an agreement among all defendants to thwart the competitive threat posed by the competitive local exchange carriers (CLECs) (i.e., independent downstream competitors), by refusing to provide access seekers with network connections and access to the same level of services that the incumbent local exchange carriers (ILECs) (i.e., vertically integrated incumbents) provided to their own customers. *See* Max Huffman, *Bell Atlantic v. Twombly*, GLOBAL COMPETITION POL'Y (May 29, 2007), http://www.globalcompetitionpolicy

extend the interpretation of joint SMP to unilateral effects in tight oligopolies under the ECNS Regulatory Framework, thus bypassing the problem of identification thereof.[36]

.org/index.php?id=476&action=907. The plaintiffs also claimed that the defendants engaged in additional parallel conduct by not competing as CLECs in each other's respective territories. In confirming previous case law under *Monsanto* and *Matsushita*, the Court held that "resisting competition is routine market conduct" and that the plaintiff failed to show that a conspiracy was "plausible," rather then simply "conceivable" or "possible." *See* Brief of Amici Curiae Economists in Support of Petitioners at 14, Bell Atlantic v. Twombly, 127 S. Ct. 1955 (2007) (No. 05-1126) ("Each of the incumbent local exchange carriers (ILECs) was accused of conspiring with the other local exchange carriers not because of any parallel action they took but because of parallel inaction they took. . . . [T]he "parallel behavior is enough" standard would include actions in which two or more firms took similar actions or, alternatively, both decided not to take an action. In the case at hand, one can easily imagine the plaintiffs claiming conspiracy in restraint of trade if all of the ILECs had in fact entered each other's territories; then the claim could have been that the ILECs did that to preempt competition from the competing local exchange carriers (CLECs)").

[36] The French regulatory authority, ARCEP, proposed such a loose interpretation twice, claiming joint dominance both in the draft notifications on the analysis of the wholesale market for access and call origination on public mobile networks and in a public consultation on the analysis of the wholesale national market for international roaming services on public mobile networks. *See* ARCEP, *Public consultation on the national market for international roaming services on public mobile telephone networks* 36 (Jan. 10, 2006), *available at* http://www.arcep.fr/fileadmin/reprise/publications/c-publique/consultang-roaming-100106.pdf ("Such a joint dominance relates to a 'tight oligopoly' market configuration of oligopolistic interdependence, of which tacit collusion is a specific case. To ARCEP's knowledge, no point of European law outlaws the use of such an economic concept to legally qualify joint dominance; thus, ARCEP esteems it has the legal backing to put forward this qualification, and notes that it can thrive as long as the Commission refrains from limiting joint dominance to tacit collusion."). The European Commission resisted this broader interpretation on the ground that the ensuing "intervention might end in overregulation, and noted how difficult it is to demonstrate an anticompetitive outcome in some circumstances. . . . Ex ante regulation is for removing structural barriers to competition, so that the remaining problems should be addressed by competition law." European Regulatory Group, 19th Plenary Meeting of the European Regulators Group 3 (Dec. 7–8, 2006), *available at* http://www.erg.eu.int/doc/meeting/erg_06_80 _19th_plenary _conclusions.pdf.

These attempts recall the debate about the perceived gap in the old substantive standard of the ECMR, where the dominance standard did not allow competition authorities to challenge concentrations likely to raise anticompetitive concerns due to unilateral (noncoordinated) effects (e.g., a substantial post-merger increase in prevailing prices), as the merged entity would not have enjoyed a position of single dominance (e.g., below the market dominance threshold). In May 2004, the Commission closed this perceived gap by introducing the significant impediment of effective competition (SIEC) standard as the principal prohibition criterion, which encompasses, but doesn't coincide with, the dominance standard.

The amended prohibition criterion expanded the coverage of the ECMR and reversed the burden of proof in favor of the investigator. Competition authorities are no longer required to argue that the market structure post-merger was conducive to tacit collusion to challenge a merger,[37] whereas it has become incumbent on the defendants to prove that their merger would not cause significant unilateral effects by invoking the efficiency defense.[38]

As explained above, the risk of cross-contamination between the new prohibitions test of the ECMR and the dominance standard

[37] However, after *Impala*, competition authorities may now be required to prove the contrary, i.e., that the post-merger market structure was not conducive to tacit collusion, to clear a merger. *See* Gisela Aigner, Oliver Budzinski & Arndt Christiansen, *The Analysis of Coordinated Effects in EU Merger Control: Where Do We Stand after* Sony/BMG *and* Impala*?*, 2 EUR. COMPETITION J. 311, 329 (2006); and Andreas M. Klees, *From "Airtours" to "Impala"—Collective Dominance Under European Merger Control*, 1 PANÓPTICA 351, 364 (2007). On July 10, 2008, the European Court of Justice (ECJ) confirmed that the standard of proof for clearance and prohibition were the same. Case 413/06-P, Bertelsmann & Sony Corp. of Am. v. Impala, 2008 E.C.R. I-0000, at ¶ 48 ("[I]t cannot therefore be inferred from the Regulation that there is a general presumption that a notified concentration is compatible with, or incompatible with, the common market.").

[38] *See* Kai-Uwe Kühn, *Reforming European Merger Review: Targeting Problem Areas in Policy Outcomes*, 2 J. INDUS. COMPETITION & TRADE 311 (2002); Yves Botteman, *Merger, Standard of Proof and Expert Economic Advice*, 2 J. COMPETITION L. & ECON. 71 (2006); Derek Ridyard, *The Commission's New Horizontal Merger Guidelines. An Economic Commentary* 3 (Global Competition Law Center, 2005), *available at* http://www.coleurop.be/content/gclc/documents/GCLC%20WP%2002-05.pdf.

within the meaning of article 82 of the EC Treaty (and the SMP standard) appears unlikely so far.[39] However, as I argue in this article, the allegation of collective dominance in the form of refusal to supply upstream access to an essential facility substantially mimics the introduction of the SIEC standard at the downstream level under article 82 of the EC Treaty.

This argument is illustrated through the analysis of the allegation of abuse of collective dominant position in the market for the provision of wholesale services of access to mobile network infrastructures, in the form of refusal to contract issued by mobile network operators (MNOs) to operators requesting access in order to act as mobile virtual network operators (MVNOs) and service providers (SPs).[40] This issue has primarily been raised in the context of market reviews within the ECNS Regulatory Framework, where four national regulatory authorities (NRAs) sought to find joint SMP in what was listed as market 15,[41]

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[39] *See* Markku Stenborg, *Forest for the Trees: Economics of Joint Dominance*, 18 EUR. J. L. & ECON. 366 (2004); Kyriakos Fountoukakos & Stephen A. Ryan, *A New Substantive Test for EU Merger Control*, 26 EUR. COMPEITION L. REV. 277 (2005); Heiko Haupt, *Collective Dominance Under Article 82 E.C. and E.C. Merger Control in the Light of the* Airtours *Judgment*, 29 EUR. COMPEITION L. REV. 434 (2002); and Giorgio Monti, *The Scope of Collective Dominance under Article 82 EC*, 38 COMMON MKT. L. REV. 1, 152 (2001).

[40] Full MVNOs are rare in practice. However, as the arguments presented here are valid regardless of the specific type of virtual operator, I will refer simply to MVNOs. For a discussion on the differences between different types of virtual operators, see Ralf Deweter & Justus Haucap, *Incentives to License Virtual Mobile Network Operators (MVNOs)*, *in* ACCESS PRICING: THEORY AND PRACTICE 303 (Justus Haucap & Ralf Dewenter eds., 2007).

[41] Market 15 corresponded to the market for wholesale access and call origination services on the public mobile telephone network, which within the ECNS Regulatory Framework was listed as a relevant market susceptible of ex ante regulatory intervention. For an overview of the analysis of market 15 in different countries, see European Regulators Group, Mobile Access and Competition Effects, Report (06) 45 (2006), *available at* http://www.erg.eu.int/doc/publications/erg_06_45_report_on_mobile_access_market_competition.pdf. It is worth noting that, following the 2007 Review of the Regulatory Framework, this market was removed from the list of "predefined" relevant markets. *See* Press Release, European Commission, From 18 to 7 Regulated Markets (Nov. 2007), http://ec.europa.eu/information_society/doc/factsheets/tr9-listofmarkets.pdf.

namely: in Ireland,[42] France,[43] Spain[44] and Malta.[45] Moreover, while in Italy an antitrust proceeding against the three incumbent global system for mobil communications (GSM) MNOs for abuse of collective

[42] However, on December 14, 2005, the communications regulator, ComReg, agreed to the annulment by the Irish Electronic Communications Appeal Panel of a decision that Vodafone and O2 were jointly dominant in the wholesale mobile access and call origination market, *See* Decision No: 08/05 of the Electronic Communications Appeals Panel in respect of Appeal Numbers ECAP6 /2005/03, 04, 05, 06, 07, 08, *available at* http://www.dcmnr.gov.ie/NR/rdonlyres /D7CB11CD-5C97-40B8-BE4C-B0E3CE90552F/0/ECAPDecisionNo0805.pdf.

[43] As explained *supra* note 26, in May 2005 ARCEP withdrew the notified draft measure whereby Orange France, SFR and Bouygues Telecom were alleged to be jointly dominant in the wholesale mobile access and call origination market. *See* Case FR/2005/0179, Notice of Withdrawal of Notified Draft Measures under Article 7 of Directive 2002/21/EC1 (2005), *available at* http://circa .europa.eu/Public/irc/infso/ecctf/library?l=/france/registeredsnotifications /fr20050179/withdrawal_noticepdf/_EN_1.0_&a=d.

[44] On February 13, 2006, the Spanish regulatory authority, CMT, adopted its final measure designating Telefonica, Vodafone and Amena as having joint SMP and requiring all three MNOs to provide wholesale access to would-be MVNOs on reasonable terms and conditions. *See* Case ES/2005/0330, Notification of Adopted Measures Pursuant to Article 7(3) of the Directive 2002/21/EC for Access and Call Origination on Public Mobile Telephone Networks (2006), *available at* http://circa.europa.eu/Public/irc/infso/ecctf /library?l=/commissiondecisions/commission_decisions_3&vm=detailed&sb =Title. Vodafone appealed the decision before the Spanish Supreme Court. It is worth noting that Vodafone also brought an action for annulment of the European Commission's letter of comments on CMT's draft notification before the Court of First Instance (CFI). In December 2007, the CFI declared Vodafone's action for annulment inadmissible and clarified that a Commission letter of comments issued within the Community consultation mechanism under article 7 of the Framework Directive does not constitute an act producing binding legal effects and is therefore not amenable to judicial review (that is, the article 7 consultation mechanism is not an approval regime). *See* European Commission, Report on Competition Policy 2007 at ¶¶ 42–48 (2008), *available at* http://ec.europa.eu/comm/competition/annual_reports/2007/part2_en .pdf. For a review of this institutional framework, see Pierre Larouche & Maartje de Visser, *The Triangular Relationship between the Commission, NRAs and National Courts Revisited*, 64 COMMS. & STRATEGIES 125 (2006).

[45] In November 2006, the Maltese regulatory authority, MCA, required the two incumbent MNOs, Vodafone and Go Mobile, to negotiate access with MVNOs on a cost-oriented basis. *See* MCA, Market Review—Wholesale

dominance is still (partly)[46] pending, the NRA is again reassessing its analysis of what constitutes market 15, which might lead to the imposition of remedies against MNOs to negotiate with MVNOs.[47]

By articulating the analysis within the decision theoretic framework, the aim is to provide an understanding of the potential cost of inappropriate intervention by regulatory and antitrust authorities. While the next part presents the general framework, part III exemplifies its application through the analysis of the allegation of abuse of collective dominance in the market for wholesale services of access to mobile network infrastructures. Part IV assesses the potential cost of inappropriate intervention and develops the ensuing policy prescriptions. Part V concludes.

II. THE ARTIFICIAL APPLICATION OF THE SIEC STANDARD UNDER ARTICLE 82 EC TREATY

The allegation of abuse of collective dominance in the form of refusal to start supplying individually owned upstream essential

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Access and Call Origination on Mobile Networks (Nov. 21, 2006), *available at* http://circa.europa.eu/Public/irc/infso/ecctf/library?l=/malta/adopted_measures/mt20060443/decision_m15pdf/_EN_1.0_&a=d.

[46] In July 2006, the Italian competition authority, AGCM, issued a statement of objections alleging TIM, Vodafone and Wind of abuse of collective dominance in the form of refusal to start supplying wholesale access to would-be MVNOs. In May 2007, the AGCM closed its investigation in reference to Vodafone after having accepted its commitments, which led to the provision of wholesale mobile access to three virtual operators.

[47] In June 2008, the Italian regulatory authority, AGCom, issued a public consultation on its findings from the (second round) market investigation review in what was then market 15 launched in April 2007. It is worth noting that the removal of a market from the list does not preclude individual NRAs from finding on the basis of national circumstances that the market meets the three criteria test and is susceptible to ex ante regulation. *See* Commission Recommendation on Relevant Products and Service Markets Susceptible of Ex ante Regulation, 2007 O.J. (L 344/65) at recital 17. In this respect, the provisional findings of the consultation thereof are that the second criterion would not be met, i.e., the presence of a market structure which would tend toward effective competition within the relevant time horizon. *See* AGCom, Identificazione ed analisi del mercato dell'accesso e della raccolta delle chiamate

inputs intertwines two theories:[48] 1) tacit collusion;[49] and 2) leverage theory in the form of complete foreclosure through refusal to deal.[50] To avoid any risk of circularity, it should first be necessary to establish the existence of collective dominance at the upstream level in order to claim that it has been unduly leveraged downstream.

As indicated in the Discussion Paper, the legal test required to establish the *existence* of collective dominance provides two steps: 1) the firms must present themselves or act as a "collective entity"; and 2) the identified collective entity must enjoy a dominant position. Regarding the first step, the Court of First Instance (CFI) has confirmed in *Impala*[51] that the finding of a collective entity is aligned to the threefold *Airtours* test, whereby it must cumulatively be established:

1. The capacity, on the part of the colluding firms, to mutually observe their conduct and to identify any deviant conduct;
2. The presence of incentives to refrain from deviating from the common conduct against the threat of credible and effective punishment strategies; and
3. The absence of market restraints, meaning the absence of power on the part of competitors and consumers to react to the negative effects of coordination.

Notwithstanding the assimilation of article 82 of the EC Treaty with the *Airtours* conditions,[52] it is sometimes argued that the different

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nelle reti telefoniche pubbliche mobile 55 (Allegato B alla Delibera n. 309/08/CONS, 2008), *available at* http://www.agcom.it/provv/d_309_08_CONS/d_309_08_CONS_all_B.pdf.

[48] The European Commission explicitly considered this anticompetitive concern in its 2005 Discussion Paper. *See* Discussion Paper, *supra* note 9, at ¶ 211.

[49] *See* Marc Ivaldi, Bruno Jullien, Patrick Rey, Paul Seabright, & Jean Tirole, *The Economics of Tacit Collusion* (Final Report for the DG Competition, European Commission, 2003), *available at* http://ec.europa.eu/comm/competition/mergers/review/the_economics_of_tacit_collusion_en.pdf.

[50] *See* Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, *in* III Handbook of Industrial Organization chap. VII (Mark Armstrong & Robert Porter eds., 2007); and Padilla & O'Donoghue, *supra* note 22, chap. 8.

[51] *See* Klees, *supra* note 37, at 363.

[52] *See* Padilla & O'Donoghue, *supra* note 22, at 150.

perspectives in the assessment of joint dominance under the ECMR and article 82 of the EC Treaty should require that the investigator's standard of proof be more stringent in the latter case.[53] In particular:

- As regards the second *Airtours* criterion, while in case of ex ante assessment under the ECMR it is sufficient to prove the existence of a potential retaliatory mechanism, the backward looking nature of article 82 of the EC Treaty should require proof of the existence of a specific retaliatory mechanism and its deterrent effect;
- On the contrary, the transposition of the third *Airtours* criterion within article 82 proceedings could be debated, given evidence of past anticompetitive effects that implies that the collective entity has been able to behave independently of its competitors, actual and potential, as well as consumers;
- Finally, the ex post perspective of article 82 of the EC Treaty should require the enforcer to provide evidence that competition between the oligopolists has been hampered.[54]

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[53] *See* Damien Geradin, Paul Hofer, Frédéric Louis, Nicolas Petit & Mike Walker, The Concept of Dominance 35 (GCLC Research Papers on Article 82 EC, 2005), *available at* http://gclc.coleurop.be (follow Research Projects), and John Temple Lang, *Oligopolies and Joint Dominance*, *in* International Antitrust Law & Policy 269 (Barry Hawk ed., 2001).

[54] In this respect, in *Impala* the CFI suggested an extensive interpretation in the assessment of a position of collective dominance. *See* Case T-464/04, Impala v. Comm'n, 2006 E.C.R. II-2289, at ¶ 251 ([I]n the context of the assessment of the existence of a collective dominant position, . . . the three conditions defined by the Court of First Instance in *Airtours v. Commission* . . . may, . . . in the appropriate circumstances, be established indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position.") The CFI further suggested with regard to apparent parallel conduct that "a finding of a common policy over a long period . . . might, in certain circumstances and in the absence of an alternative explanation, suffice to demonstrate the existence of a dominant position, as opposed to the creation of such a position." *Id.* at ¶ 254. However, the ECJ further qualified this approach in Case 413/06P, *Bertelsmann & Sony Corp. of Am. v. Impala*, 2008 E.C.R. I-0000, at ¶ 129 ("the investigation of a pre-existing collective dominant position based on a series of elements normally considered to be indicative of the presence or the likelihood of tacit coordination between competitors cannot therefore be considered to be objectionable of itself. However, . . . it is essential that such an investigation be carried out with care and, above all, that it should adopt an approach based on the analysis of such

However, and correspondingly:

- "[I]t would be wrong to conclude that the absence of evidence of actual use of a retaliatory mechanism implies that no effective punishment mechanism exists: the most effective mechanism is one where the mere prospect of retaliation is so effective that no actual deviation occurs."[55] Therefore, the requirement to prove the existence of a specific retaliatory mechanism and its deterrent effect should be relevant only insofar as there is evidence of past deviations from the common course of conduct[56];
- The implication that the evidence of past anticompetitive effects excludes the ability of actual and potential competitors to disrupt tacit collusion could be misleading when dealing with alleged exclusionary (rather than exploitative) abuses, in particular, when in the form of refusal to start supplying wholesale access, which does not pose a direct threat to vertically integrated actual and potential competitors;
- As noted in the previous part, the observation of parallel inaction from the alleged colluding firms is far from an unambiguous piece of evidence that competition between the alleged colluding firms has been hampered.[57]

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plausible coordination strategies as may exist in the circumstances." In particular, "the assessment . . . should not be undertaken in an isolated and abstract manner, but should be carried out using the mechanism of a hypothetical tacit coordination as a basis." *Id.* at ¶ 126.

[55] PADILLA & O'DONOGHUE, *supra* note 22, at 158. Indeed, the European Commission did apply this stronger burden of proof retrospectively in the assessment of the *existence* of a position of collective dominance. In *Sony/BMG*, it ruled out the possibility that the proposed concentration would have either strengthened a premerger or created a post-merger position of collective dominance with reference also to the absence of evidence of past retaliation. *See Impala*, 2006 E.C.R. II-2289, at ¶ 187. However, the CFI rebuked the Commission's reasoning with regards to deterrence and retaliation. *Id.* at ¶ 466 ("The mere existence of effective deterrent mechanisms is sufficient, in principle, since if the members of the oligopoly conform with the common policy, there is no need to resort to the exercise of a sanction.").

[56] *See* Aigner et al., *supra* note 37.

[57] It is worth remembering that this line of enforcement would be in stark contrast with the one recently endorsed by the U.S. Supreme Court in *Twombly*, which, on the contrary, has raised the pleading bar substantially for antitrust claims predicated on "consciously parallel" conduct. Bell Atlantic Corp. v. Twombly, 127 U.S. 1955 (2007).

These considerations are even more relevant under the ECNS Regulatory Framework, where NRAs are required to conduct a forward-looking, structural evaluation of the relevant market based on existing market conditions.[58]

As regards the anticompetitive profile of a practice of refusal to start supplying an input, the Discussion Paper outlines five cumulative conditions that should be fulfilled to find an abusive refusal to start supplying:[59]

1. The behavior can be properly characterized as a refusal to supply;
2. The refusing undertaking is dominant;
3. The input is indispensable, in that no real or potential substitutes exist in the market;
4. The refusal is likely to have a negative effect on downstream competition; and
5. The refusal is not objectively justified, i.e., because of reputation concerns, technical/capacity constraints, or the need to properly recover sunk costs originally committed under uncertainty.

As regards the burden of proof, the proposed framework places on the defendants the onus of proving the existence of an objective justification or an efficiency defense.[60] Some commentators have contested this proposal, as it aligns the enforcement of article 82 EC with that of article 81(1) and (3) EC, under which there is a presumption of anticompetitiveness, and the burden of proof of providing an objective justification or invoking an efficiency defense is incumbent upon the defendant.[61] On

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[58] Commission Guidelines on Market Analysis and the Assessment of Significant Market Power under the Community Regulatory Framework for Electronic Communications Networks and Services ¶ 20, 2002 O.J. (C 165/6) [hereinafter SMP Guidelines]. Indeed, the principal rationale for adopting a forward-looking perspective was "the lack of evidence or of records of past behaviour or conduct." *Id.* at ¶ 70. Arguably, this concern was primarily directed at past monopolized markets and thus is unlikely to be a reason for concern in the oligopolistic mobile industry.

[59] Discussion Paper, *supra* note 9, at ¶ 9.2.2.

[60] *Id*. at ¶ 77.

[61] *See* Einer Elhauge, Comments on General Framework, *available at* http://ec.europa.eu/competition/antitrust/art82/elhauge.pdf and Eleanor

the one hand, while the establishment of anticompetitive effects must not be presumed, but be assessed in a unitary way, this alignment would prevent a dominant firm from being treated better under article 82 EC than a nondominant one under article 81(1) & (3) EC.[62] On the other hand, the existing difference in the allocation of the burden of proof between the two antitrust provisions is justified in light of the ubiquity of unilateral practices compared to voluntary agreement.[63]

This tension is at the core of the identification problem mentioned above, whereby the absence of supply agreements at the wholesale level is consistent with either tacit collusion or lawful noncoordinated unilateral practices. In other words, what could be characterized as an unlawful refusal to deal if done by an individual dominant firm should instead be held lawful unless the firm is found to have joined a position of collective dominance.[64] In any case, making the correct

M. Fox, Comments on the Discussion Paper of DG Competition on the Application of Article 82 of the Treaty to Exclusionary Acts (Mar. 31, 2006), *available at* http://ec.europa.eu/competition/antitrust/art82/083.pdf. It is worth nothing that this approach would be in contrast to the allocation of the burden of proof implied by the U.S. Supreme Court in *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398 (2004), whereby the *welfare balancing* approach was rejected in that the defendant did not have a substantial procompetitive justification. The AMC Report relied on this decision in recommending that "[r]efusals to deal with horizontal rivals in the same market should rarely, if ever, be unlawful under antitrust law, even for a monopolist." AMC REPORT, *supra* note 1, at 101 (footnote omitted). *See* Keith N. Hylton, *Unilateral Refusals to Deal and the Antitrust Modernization Commission Report*, 53 ANTITRUST BULL. 623 (2008). For a contrasting view, see Jonathan L. Rubin, *The Truth About* Trinko, 50 ANTITRUST BULL. 725 (2005).

[62] Philip Lowe, *Public Hearing on Article 82, Part 4—Refusal to Supply* (June 14, 2006), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/hearing.html.

[63] Elhauge, *supra* note 16. *See also* American Bar Association, *Comments on the Staff Discussion Paper* 8 n.11 (2006) (on file with author).

[64] The circumstances under which a unilaterally rational refusal to start supply from a dominant firm could be held to be abusive ultimately depend on the general standard adopted for abusive conduct. By and large, there seems to be an opposition between a welfare balancing approach, whereby the gains in terms of improved (static) allocative efficiency (i.e., low prices and higher output) might justify intervention, and the so-called no economic

inference may be particularly problematic with regard to the first condition, as it may be difficult to establish whether the absence of wholesale transactions is the result of "constructive" refusal to deal, where the upstream provider insists on unreasonable access terms, which would impede an efficient downstream operator from being profitable. In this respect, there are obvious similarities with the margin squeeze abuse,[65] in that it would be necessary to estimate the downstream costs of an efficient competitor and determine whether the defendant's margin between its wholesale and retail prices would allow covering those costs and earning a competitive return.[66] How-

sense standard advocated by the U.S. Department of Justice, which would not condemn the refusal to deal as long as it made economic sense *regardless* of its tendency to eliminate or lessen competition. Some commentators argued that in *Trinko* the U.S. Supreme Court implicitly endorsed the latter standard, recalling that the second distinction the Court drew between *Trinko* and *Aspen* was based on the pricing behavior, where Justice Scalia noted that "[i]n *Aspen Skiing*, the defendant turned down a proposal to sell at its own retail price, suggesting . . . that its future monopoly retail price would be higher," while "Verizon's reluctance to interconnect at the cost-based rate of compensation . . . tells us nothing about dreams of monopoly." *See Trinko*, 540 U.S. at 408. *See also* George A. Hay, Trinko*: Going All the Way*, 50 ANTITRUST BULL. 527 (2005); David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73 (2005); and Hylton, *supra* note 61. For an opposite view, see Rubin, *supra* note 61.

[65] *See* Michele Polo, *Price Squeeze: Lessons from the Telecom Italia Case*, 3 J. COMPETITION L. & ECON. 453 (2007); Laura Ferrari Bravo & Paolo Siciliani, *Exclusionary Pricing and Consumer Harm: The European Commission's Practice in the DSL Market*, 3 J. COMPETITION L. & ECON. 243 (2007); Damien Geradin & Robert O'Donoghue, *The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector*, 1 J. COMPETITION L. & ECON. 355 (2005). This issue has recently been debated in the United States in reference to *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.*, No. 07-512 (Feb. 25, 2009), a case before the U.S. Supreme Court. *See* Dennis Carlton, *Should Price Squeeze Be a Recognized Form of Anticompetitive Conduct?*, 4 J. COMPETITION L. & ECON. 271 (2008).

[66] *See* PADILLA & O'DONOGHUE, *supra* note 22, at 434. Technically speaking, the reasonableness of access terms should not be equated to cost-orientation, as a no less efficient would-be competitor should be able to pay the monopoly price for the upstream input and compete against the vertically integrated firm downstream, while still earning a competitive return. That is, in a situation with first refusal to supply, the no economic sense standard may coincide with the "as efficient competitor" standard. *See* Hay, *supra* note 64, at n.64.

ever, a difference exists in that an allegation of margin squeeze is logically posited on the existence of a duty to deal, whereas a case of refusal to start supplying an input should require the competitive assessment of the downstream market first, rather than of the margin between prevailing downstream prices and the allegedly excessive terms offered to purchase the upstream input.

In this respect, criterion #4 above should be strengthened by further qualifying that downstream foreclosure must ultimately be "to the detriment of consumers in both the short and the long term."[67] This should be particularly so for *collective* refusal to start supplying to avoid the risk of circularity mentioned above. In this respect, the Discussion Paper correctly clarified that "the extent to which the exclusion of one competitor has an impact on the level of competition depends on the pre-existing competition on the downstream market."[68] A cautious interpretation of what those pre-existing competitive conditions should be in order to trigger antitrust intervention at the upstream level is that there should at least be an absence of "effective competition" on the market, i.e., (collective) dominance on the relevant downstream market.[69] However, this consideration suggests the question of why article 82 of the EC Treaty was not directly enforced to tackle anticompetitive concerns at the downstream level, in particular, when the ultimate harm to consumers is due to high prices rather than reduced innovation.[70] This is particularly relevant to the

[67] Opinion of Advocate General Jacobs in Case C-7/97, Oscar Bronner GmbH & Co K v Mediaprint Zeitungs- undZeitschriftenverlag GmbH 1998 E.C.R. I-7791, ¶ 51.

[68] Discussion Paper, *supra* note 9, at ¶ 231.

[69] PADILLA & O'DONOGHUE, *supra* note 22, at 444. In this respect, see Canadian Competition Bureau, Information Bulletin on the Abuse of Dominance Provisions as Applied to the Telecomminications Industry (June 6, 2008), *available at* http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/en/02690e.html. The first condition set out to assess an allegation of abuse of dominance involving denial of access to a facility requires "a vertically integrated firm that has market power in the downstream (or retail) market for which the facility is an input in the time period following the denial." *Id.* at ¶ 4.2.2.i.

[70] In this regard, in June 2008, the Spanish competition authority, CNC, accused the three GSM incumbent operators, Vodafone, Orange and Movistar, of tacit collusion in the form of parallel pricing.

issue discussed in this article where the principal anti-competitive concern is the foreclosure of so-called "no-frills" MVNOs, whose distinctive proposition consisted of discounting basic mobile services.

However, as explained in the previous part, intervention under article 82 of the EC Treaty against exploitive abuses of collective dominance at the downstream level might not be appropriate in circumstances where prices are above competitive levels, but not excessively so. Moreover, the Discussion Paper stressed the importance of the identity of the foreclosed potential competitor in determining the likely negative impact on competition, for instance if it follows a different business model than the established competitors on the market.[71] Similarly, although intervention at the downstream level in order to tackle the mere existence of SMP is admissible within the ECNS Regulatory Framework,[72] such an intervention should be envisaged only where the imposition of access obligations at the upstream level did not result in effective competition at the retail level.[73] In any case, the European Commission has repeatedly rebutted the cautious interpretation thereof, for instance, in its comments to the Spanish NRA, the Telecommunications Market Commission (CMT), in reference to the latter's draft notification assessing the national wholesale market for the provision of mobile access and origination services:

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[71] Discussion Paper, *supra* note 9, at ¶ 232.

[72] A possible explanation is that given that almost all the electronic communication markets were formerly monopolized, competition law may not have been an efficient instrument for liberalization because a liberalization based solely on competition law would have been postponed. However, this argument does not apply to the mobile industry, which has always been characterized by an oligopolistic market structure. In a similar fashion, in *Trinko*, the U.S. Supreme Court placed great emphasis on the regulatory context of the case, whereby an antitrust violation was unlikely or the benefit of antitrust intervention would have been greatly outweighed by its costs. *See* Rubin, *supra* note 61, at 726–37; and Philip J. Weiser, *The Relationship of Antitrust and Regulation in a Deregulatory Era*, 50 ANTITRUST BULL. 549 (2005). In any case, antitrust enforcement may yet have a key deterrent role. *See* Roger D. Blair & Christine A. Piette, *The Interface of Antitrust and Regulation:* Trinko, 50 ANTITRUST BULL. 665 (2005).

[73] SMP Guidelines, *supra* note 58, at ¶ 84.

> It should be noted that in order to find joint SMP in the wholesale market of mobile access and call origination, it is not indispensable to find joint SMP at the retail level. . . . However, in order to render credible the finding of collusion at the wholesale level CMT had to demonstrate that the level of rents at the retail level is sufficiently high to provide incentives to collectively refuse access to third operators. If at the retail level there were no rents to protect, then the incentive of mobile network operators not to grant access to MVNOs is difficult to demonstrate.[74]

That is, the existence of a tight oligopoly at the retail level (albeit not collusive) can trigger regulatory intervention at the wholesale level against the existence of joint SMP, which substantially coincides with the enforcement of article 82 of the EC Treaty against an abuse of collective dominance in the form of refusal to start supplying. Notwithstanding this controversial enforcement policy,[75] one would expect that this is not the same as closing the gap by artificially introducing the SIEC standard in the application of article 82 of the EC Treaty to exploitative abuses at the downstream level, as the plaintiff still should have to comply with the onus of proof required to substantiate the existence of tacit collusion at the upstream level. However, the combined application of these two antitrust provisions may generate a counterintuitive allocation of the burden of proof which would substantially close the gap.

The conditions underpinning tacit collusion at the upstream level can be conveniently illustrated with a stylized two-firm access game, where two symmetric, vertically integrated duopolists consider whether or not to grant upstream access to independent downstream competitors, as shown in figure 1.[76]

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[74] European Commission, Comments Pursuant to art. 7(3) of the Framework Directive—Case ES/2005/0330, http://circa.europa.eu/Public/irc/infso/ecctf/library?l=/espaa/registeredsnotifications/es20050330/final_enpdf_15/_EN_1.0_&a=d.

[75] MASSIMO MOTTA, COMPETITION POLICY 138 (2004) ("In economics, collusion is a situation where firms' prices are higher than some competitive benchmark. A slightly different definition would label collusion as a situation where firms set prices which are close enough to monopoly prices. In any case, in economics collusion coincides with an outcome (high-enough prices), and not with the specific form through which that outcome is attained.").

[76] *See also id.* at 408 and Carruthers, *supra* note 30.

Figure 1
PD as an Access Game

	Access	No Access
Access	(a,a)	(c,d)
No Access	(d,c)	(h,h)

Within this framework, tacit collusion can be seen as the solution of a repeated prisoner's dilemma (PD) whereby repetition of the one-shot game motivates cooperation by placing the game in the "shadow of the future."[77] To have a PD, the only noncooperative Nash equilibrium of the stage-game must be one with access provided by both incumbents, even though they would be better off without access, that is: 1) payoff a > payoff d; 2) payoff c > payoff h; and 3) payoff h > payoff a. In particular, the second condition requires that granting access is unilaterally profitable (assuming that the other duopolist doesn't supply access). Otherwise, there would be a coordination game, where the outcome without access could be selected either via the principle of Pareto-dominance (i.e., no access on both sides is a second Nash equilibrium of the stage-game where players are better off than when both provide access), or through the elimination of weakly dominated strategies (i.e., once a player has provided access, the other is indifferent between granting access as well or not: payoff d = payoff a).[78] In any case, the decision not to provide wholesale access to independent downstream competitors would be unilaterally rational, i.e., a decision taken independently, rather than with a view to influencing the conduct of the other incumbent.[79]

77 Robert Axelrod, The Evolution of Cooperation 12 (1984).

78 *See* Motta, *supra* note 75, at 545.

79 Indeed, those equilibrium selecting criteria have been discussed to explain how firms could (tacitly) coordinate on a particular collusive outcome (i.e., when there are many), that is, provided that each possible collusive equilibrium already satisfies the incentive compatibility restraints which are necessary to support a collusive agreement. *See* Luís M.B. Cabral, *Collusion Theory: Where to Go Next?*, 5 J. Indus. Competition & Trade 199 (2005).

This observation is consistent with the requirement that the *Airtours* test also applies to the assessment of the *existence* of collective dominance, which implies that the incentive structure of the stage-game must be in the form of a PD. This is particularly important in light of the sequential nature of the game. Indeed, the likely scenario would be one where only one firm refuses to start supplying wholesale access (or there is a sequence of refusals). This scenario would be consistent with both a PD and a coordination setting. However, only in the former case would the first refusal to start supplying amount to an *individual* abuse of a position of collective dominance[80]; whereas although in the latter case the first refusal might facilitate coordination on selecting the outcome, without access it still would be a legitimate unilateral decision not posited on the existence of collective dominance.

It is essential to focus on the assessment of the unilateral incentives to provide wholesale access to downstream competitors, rather than on the absence of wholesale transactions in light of so-called "pent-up" demand or the observation that entry has occurred elsewhere.[81] In this respect, in the short term this assessment depends on the trade-off between the incremental (and differential) profits from selling wholesale access to hosted operators and the negative competitive effect at the retail level following their entry, resulting in a generalized decrease in prevailing price levels and in the cannibalization of the host's consumer base.[82]

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[80] *See* WHISH, *supra* note 21, at 529.

[81] *See*, *e.g.*, European Commission, *supra* note 74, at 6:

> CMT considers that denial of wholesale access to MVNOs is a feature of tacit collusion to sustain high levels of profitability at the retail level. In this respect CMT notes that access agreements have been negotiated voluntarily in many Member States (UK, France, Germany, Belgium, Austria, Norway, Sweden, Finland, Denmark) while in Spain there is unsatisfied demand of service providers seeking access to MNOs' networks. CMT has granted MVNO licenses to 10 operators and 119 operators have been granted authorizations to resell mobile services none of which have been able to conclude an access agreement with any of the three MNOs. In consequence CMT has received complaints for alleged refusal to supply against all three MNOs.

[82] Some authors have emphasized that one-way access pricing agreements can also serve as instruments of collusion, whereby a high input price can reduce the intensity of downstream price competition, resulting in more

Furthermore, given the plurality of vertically integrated incumbents, the competitive effect could be realized even though wholesale access has been unilaterally denied if the other player decides differently.[83]

Therefore, it is essential to understand what downstream competitive conditions are necessary to populate the above matrix so as to shape the access game in the form of a PD. As already explained, if downstream competition is effective so that no supernormal profits are made at the downstream level, not granting access to a new entrant cannot have an anticompetitive intent, as vertically integrated incumbents would earn a normal profit, regardless of downstream entry patterns.[84]

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monopolistic outcomes than would have occurred if the entrant had self-provided the input. However, these prescriptive results depend on the upstream market being monopolized, but, eventually, by-passable through upstream vertical integration by the access seeker. *See* David E. Sappington, *On the Irrelevance of Input Prices for Make or Buy Decisions*, 95 AM. ECON. REV. 1631 (2005); David E. Sappington & Burcin Unel, *Privately-negotiated Input Prices*, 27 J. REG. ECON. 263 (2005); and David Harbord & Marco Ottaviani, *Anticompetitive Contracts in the UK Pay-TV Market*, 23 EUR. COMPETITION L. REV. 122 (2002).

[83] *See* Janusz Ordover & Greg Shaffer, *Wholesale Access in Multi-Firm Markets: When is it Profitable to Supply a Competitor?*, 25 INT'L J. INDUS. ORG. 1026 (2007); Deweter & Haucap, *supra* note 40; Duarte Brito & Pedro Pereira, *Access to Bottleneck Input under Oligopoly: A Virtual Prisoners' Dilemma?*, (unpublished manuscript, Portuguese Competition Authority, 2007), *available at* http://www.autoridadedaconcorrencia.pt/download/WP16_Bottleneck_July_2007.pdf. Marc Bourreau, Johan Hombert, Jerome Pouyet & Nicolas Schutz, *Wholesale Markets in Telecommunications* (unpublished manuscript, CEPR, 2007), *available at* http://www.cepr.org/pubs/new-dps/dplist.asp?dpno=6224, abstract away from the issue of complete foreclosure and focus on whether there can be noncooperative equilibriums with noncompetitive outcomes even with wholesale entry. Their intuition is that the vertically integrated supplier has an incentive to raise its downstream price to better accommodate the new downstream entrant, i.e., a so-called "softening effect."

[84] The Chicago school critique argued that while dominant upstream firms may have the ability to leverage their market power, they rarely have the incentive to do so under conditions of effective downstream competition, as a more efficient downstream competitor could be the source of extra monopoly profit—the so-called single monopoly profit theorem. *See* ROBERT BORK, ANTITRUST PARADOX 228–29 (1978); and RICHARD POSNER, ANTITRUST LAW 199–200 (1976).

Therefore, effective downstream competition is a sufficient (but not necessary)[85] condition to rule out tacit collusion at the wholesale level.[86]

Nevertheless, when downstream competition is imperfect, so that supernormal profits are made even in the absence of downstream collective dominance (i.e., tight oligopoly), strategic interaction between vertically integrated ologopolists may be in the form of a PD, whereby incumbents would collectively lose from starting to supply upstream access to downstream competitors,[87] but have unilateral incentives to do so.[88] In this respect, although the corresponding liter-

[85] *See* Martin Cave, Ulrich Stumpf & Tommaso Valletti, *A Review of Certain Markets Included in the Commission's Recommendation on Relevant Markets Subject to ex ante Regulation* 92 (July 2006), *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/info_centre/studies_ext_consult/review_experts/review_regulation.pdf.

[86] In this respect, a first screening piece of analysis would be to compare prevailing retail conditions to comparable countries where downstream competition is deemed to be effective, having regard to benchmark actual average prices rather than prices for a typical usage profile or revenue figures. *See* Jerry A. Hausman & Gregory J. Sidak, *Evaluating Market Power Using Benchmark Prices instead of the Herfindahl-Hirschman Index*, 74 ANTIRUST L.J. 395, 403 (2007).

[87] The single monopoly profit theorem is robust also to a variety of downstream imperfectly competitive market structures, provided that the upstream monopolist is able to credibly make enforceable multilateral commitments. *See* Michael H. Riordan, *Competitive Effects of Vertical Integration* (unpublished manscript, Columbia University, 2006), *available at* http://www.columbia.edu/~mhr21/Vertical-Integration-Nov-11-2005.pdf. Otherwise "[a] bottleneck owner faces a commitment problem similar to that of a durable-good monopolist: Once he has contracted with a downstream firm for access to its essential facility, he has an incentive to provide access to other firms as well, even though those firms will compete with the first one and reduce its profits. This opportunistic behaviour *ex ante* reduces the bottleneck owner's profit (in the example just given, the first firm is willing to pay and buy less)." Rey & Tirole, *supra* note 50, at 12. This commitment problem becomes more severe the larger the number of downstream firms. Therefore, vertical integration/restraint is seen as a credible commitment device, in order to eliminate the temptation of opportunism and make the bottleneck owner commit itself to reducing supplies to downstream firms. *Id.* at 21. *See also* MOTTA, *supra* note 75, at 356. Analogously, tacit collusion may be framed as a credible commitment device that enables the collective entity to credibly enforce multilateral commitments not to flood the downstream market.

[88] *See* Cave, Stumpf & Valletti, *supra* note 85.

ature is still burgeoning, with several settings being modelled, a few general conclusions can be drawn:

- Incumbents will be more likely to grant wholesale access to would-be downstream competitors under Cournot competition and with cannibalization being proportional to firms' market share[89];
- In contrast, the incentives to voluntarily grant wholesale access are lower under Bertrand competition unless the services offered by independent downstream competitors are sufficiently differentiated[90]; and
- Unilateral incentives to provide wholesale access are stronger the more incumbents' market shares are asymmetric, i.e., as the threat to be preempted by the weakest incumbent makes the larger operators more likely to provide access in order not to lose wholesale revenue.

However, these results rest on three assumptions, which might be viewed as shortcomings, when tested against actual modes of competition in the mobile industry. Specifically, these are:

- Entry cost is fixed, whereas it would be reasonable to assume that the entry fee to position the brand should vary with the budgeted (targeted) market share. This is particularly relevant given the importance of product differentiation and that marketing and promotional expenses are likely to be largely sunk;
- New entrants expand the overall market size.[91] This feature softens the negative impact of cannibalization, whereas in saturated markets cannibalization would be harsher; and

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[89] While Ordover & Shaffer model differentiated quantity competition, Dewenter & Haucap do use a setting with homogeneous Cournot competition. However, the latter's results rest on the assumption that the incumbent can extract the entire profit of the downstream competitor hosted by means of a two-part tariff, i.e., the hosting operator enjoys full bargaining power.

[90] These findings mirror a corollary result from the economics of horizontal mergers where divisionalization (the opposite of horizontal concentration), and accordingly the provision of access to downstream competitors, is not generally profitable under differentiated Bertrand competition, whereas it is more profitable under Cournot competition. *See* Deweter & Haucap, *supra* note 40, at 316. Furthermore, the unilateral disincentives to start supplying access under Bertrand competition are even stronger when the entrant inherits some of the differentiating features of its host, thus resulting in disproportionate cannibalization at the expense of the supplying incumbent. *See* Ordover & Shaffer, *supra* note 83, part 5.

[91] Technically speaking, the demand specifications used in both Ordover & Shaffer and Dewenter & Haucap are so-called representative consumer

- Cannibalization is proportional to market shares. There is no particular reason to justify this assumption but for its simplicity. In particular, it seems reasonable that cannibalization would hurt "weaker" vertically integrated incumbents more than proportionally, and vice versa. This alternative specification would undermine the threat of preemption from minor/weaker incumbents.

Furthermore, all reviewed models are focussed on the incumbents' short term incentives in a static way, thus disregarding the incentives to invest in and promote next-generation services. As presented later on, this should instead be a crucial consideration in the assessment of incumbents' unilateral incentives to grant wholesale access to independent downstream competitors.

In any case, it is useful to investigate whether those general theoretical prescriptions broadly fit with observed stylized facts by comparing the performance of MVNOs in the United States and Europe.[92] Unlike their counterparts in Europe, MVNOs in the United States largely redefined the then-marginal prepaid market segment and have enjoyed tremendous initial success. In contrast to the services offered by most MNOs, MVNOs focused predominantly on the prepaid market segment using value propositions that consisted of conveniently priced services that do not involve long-term contracts, credit checks, or early termination fees. On the contrary, in Europe, the early success of prepaid services and the relatively quick adoption of wireless services caused wireless penetration rates to rise dramatically over the last decade (approaching 100% in the majority of European countries). As a result, MVNOs were less likely to add value by offering prepaid services as they did in the United States.

Therefore, while in the United States MVNOs' product was differentiated (in comparison to their hosting provider) and also able to substantially expand the market, in Europe mobile saturation and the high penetration of prepaid services meant that the MVNO competition pat-

models of product differentiation, where the market size increases with the increase in the variety of goods sold. On the contrary, in Brito & Pereira's formulation, the market size is fixed in that they make use of Salop's topology, i.e., the so-called circular-road model.

[92] ANIRUDDHA BANERJEE & CHRISTIAN DIPPON, MOBILE VIRTUAL NETWORK OPERATOR: BLESSING OR CURSE? (2006).

tern could be characterized as mainly based on price for basic homogeneous voice and data services, without any significant market-expanding effect.[93] These are, by and large, the sorts of features that would make the decision to start supplying wholesale access unilaterally irrational.

As explained above, the backward looking nature of the investigation of dominance abuses should require the plaintiff to produce evidence of hampered competition among competitors. In this respect, the alleged abuse of refusal to start supplying could be taken as evidence in itself of hampered competition at the wholesale level (in particular, in the presence of a so-called pent-up demand). However, evidence of imperfect downstream competition is not unambiguously proof of upstream tacit collusion. Therefore, to argue that the absence of wholesale transactions and the imperfectness of downstream competition would prove the existence of upstream collective dominance is a non sequitur, as affirming the consequences does not necessarily imply the premise.[94]

However, to invoke the second *Airtours* criterion incidentally solves this logical fallacy. To argue that the plaintiff has fallen short of proving the existence of a credible and effective punishment mechanism may backfire on the defendants, as it implies that deviation would be profitable, that is, supplying upstream access to downstream competitors would be unilaterally rational. Thus, this line of reasoning tends to imply that, according to the defendants, the factual absence of wholesale transactions is consistent only with the presence of effective downward competition,[95] as otherwise imperfect competition would command downstream entries.

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93 *See* Hausman & Sidak, *supra* note 86, at 393, 400.

94 In reference to the Irish case, see Hausman & Sidak, *supra* note 86, at 394:

> ComReg never investigated the question of potential profitability of MVNOs in Ireland. Instead, ComReg concluded that "it is rational [for MNOs] to allow access and therefore denial of access in this instance sustains the case for tacit collusion." Thus, ComReg essentially "worked backwards" from the finding of no MVNOs to "tacit collusion" to "joint dominance." This approach to a determination of SMP has been rejected by many competition authorities where SMP must be demonstrated apart from a given market action—for example, the decision not to supply MVNOs.

95 *See*, *e.g.*, *id.* at 398.

Therefore, an incongruence emerges between the plaintiff's argument that downstream imperfect competition and the absence of wholesale transactions are the outcome of upstream collective dominance and the defendants' argument that tacit collusion is unlikely given the absence of an effective and credible retaliatory mechanism. This incongruence boils down to the existence of a tight oligopoly at the downstream level—if extra rents are earned downstream, the absence of wholesale transactions is unambiguously evidence of upstream tacit collusion, given the defendants' claim that (otherwise) entry would occur. This logical forcing on the part of the plaintiff substantiates the synthetic reversal of the burden of proof that would occur in the application of the SIEC standard in an antitrust proceeding challenging the existence of an exploitive tight oligopoly at the downstream level. As demonstrated in part IV, this synthetic reversal of the burden of proof could ultimately lead to a low level of enforcement of collective dominance under article 82 of the EC Treaty, which may cause costly type I errors (i.e., false positives).

However, as exemplified in the next part, this bias could be addressed by thoroughly applying the third *Airtours* criterion, in particular, by investigating the effectiveness of the competitive constraint provided by competitors deemed to be outside the tacit collusive agreement. Contrary to what the ex post perspective of article 82 of the Treaty would suggest, the plaintiff should assertively investigate to what extent there exists a so-called maverick firm at both the retail and the wholesale level. As regards the retail level, the presence of a maverick firm would strongly suggest that downstream competition is effective, so that the absence of wholesale transactions is not indicative of harm to final consumers.

More importantly, the existence of a vertically integrated competitor outside the alleged tacit collusive agreement that has the capability and the incentive to act as a maverick also at the wholesale level would redress the described logical forcing that generates the synthetic reversal of the burden of proof. The circumstance that the maverick has also refused upstream access would strongly indicate that the status quo was a noncoordinated outcome, even under conditions of imperfect downstream competition.

These two counterintuitive results carry strong implications in terms of the optimal allocation of the burden of proof as regards the balancing of procompetitive and anticompetitive effects of a practice between the plaintiff and the defendants. As a general principle, economics and empirical evidence tend to presume that vertical restraints are procompetitive,[96] or at least not presumptively anticompetitive, thus requiring a strong burden of proof on the plaintiff in order to condemn such practices.[97] Therefore, in light of the decision theoretic framework,[98] the reversal of the burden of proof described above and the ensuing risk of low enforcement of collective dominance under article 82 of the EC Treaty should require the plaintiff to thoroughly verify the compliance with the third *Airtours* criterion, as the second criterion might be conducive to logical fallacies that would ultimately give rise to costly false positives.

Eventually, while being less taxing and contentious, this line of investigation would lead to the same conclusion as directly assessing whether the alleged colluding firms had the unilateral incentive to provide wholesale access. However, it is worth stressing that to avoid the risk of circularity it should be good practice to focus the investigation on whether there are incentives to *arrive* at tacit collusion in the first place (rather than stick to it), as the same set of arguments denying the existence of a credible retaliatory mechanism tends, at the same time, to make it less plausible that refusing to start supplying wholesale access may be the result of a unilateral rational decision, thus forcing the defendant to argue in a counterproductive way.

This may be particularly contentious in cases in which the plaintiff resorts to Nash-reversion as the punishment path, whereby, upon

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96 *See* James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); and Francine La Fontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., 2008).

97 *See* Evans & Padilla, *supra* note 64.

98 *See* Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973); Paul L. Joskow & Alan K. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213 (1979); and Frank H. Easterbrook, *The Limits of Antitrust*, 64 TEX. L. REV. 1 (1984).

detection, cheating firms revert to their "normal"[99] competitive pattern over the foreseeable future (so-called grim-trigger strategies).[100] On the one hand, the Nash-reversion trigger strategy is both simple[101] and credible.[102] On the other hand, this might indeed be the *only* credible punishment path available. This is because the decision to grant access to downstream competitors would hardly be reversible (i.e., not least due to the risk of antitrust enforcement when eventually terminating supply), which in turn makes the Nash-reversion competitive response irreversible as well, thus questioning whether it could possibly be seen as retaliation in the first place. In other words, it would be foolish not to consider what strategic reactions the decision to host a downstream competitor would produce, given that (contrary to the decision to undercut rivals) it would irreversibly alter the strategic setting down the road, *regardless* of the degree of mutual

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[99] *See* Patrick Rey, *Collective Dominance and the Telecommunications Industry*, *in* THE ECONOMICS OF ANTITRUST AND REGULATION IN TELECOMMUNICATIONS (Pierre A. Buigues & Patrick Rey eds., 2004).

[100] In this respect, two types of retaliatory mechanism were advanced primarily by NRAs, specifically: 1) at the wholesale level, by either attracting the MVNO hosted by the deviating MNO to the network of the nondeviating MNO, or (more plausibly) by hosting another MVNO; and 2) at the retail level, by reducing retail prices through specific offers (be it through effective reduction of nominal prices or through a more aggressive, but also more reversible, promotion policy). The European Commission considered the latter option to be more credible because more promptly executable and involving lower transaction costs than elaborate negotiations with third parties. European Commision, *supra* note 74, at 9.

[101] In particular, simplicity is key for tacit collusion, where the lack of communication between firms renders coordination (and thus awareness) of punishment (and, in the first instance, of the collusive outcome) much more difficult than with overt collusion. *See* Switgard Feuerstein, *Collusion in Industrial Economics—A Rejoinder*, 5 J. INDUS. COMPETITION & TRADE 235 (2005). For a critical view of the use of Nash reversion compared to optimal punishment paths, see Cabral, *supra* note 79, and Kai-Uwe Kühn, *Collusion Theory in Search of Robust Themes: A Comment on Switgard Feuerstein's Survey*, 5 J. INDUS. COMPETITION & TRADE 207 (2005).

[102] In technical terms, credibility requires that the chosen punishment path is a subgame perfect Nash equilibrium, that is, it does not imply actions that would not be taken in case the punishment threat was not sufficient to deter cheating. *See* MOTTA, *supra* note 75, at 549.

recognition among alleged colluding firms, which is the building block of tacit collusion. These considerations deeply call into question the theoretical prescription that the assessment of firms' unilateral incentives should be restricted to the strategic interaction in the static one-shot game, as the irreversibility of the decision being assessed means that the structure of the stage-game will change, thus modifying the corresponding static Nash equilibrium over the foreseeable future. That is, there is an issue of whether it is correct to use the framework of tacit collusion, as the dynamic nature of strategic interaction is not one of *repetition* of the same one-shot game.[103]

The ambiguities due to the contentious allocation of the burden of proof can also be framed in light of the legal test for the practice of refusal to start supplying described above. The presence of a maverick firm at the wholesale level is also indicative that upstream access to the facilities individually owned by the defendants is not indispensable, as an actual (or potential) substitute would be available. Moreover, it also reaffirms the importance of rigorously assessing the extent to which the likely negative effects on downstream competition have been (are, or are going to be), ultimately, to the detriment of consumers. In this respect, while the proposed test shifts the onus of providing an objective justification for the alleged anticompetitive refusal

[103] Kai-Uwe Kuhn & John Michael Van Reenen, *Capacity Constraints and Irreversible Investments: Defending Against Collective Dominance in UPM Kymmene/Norske Skog/Haindl*, *in* CASES IN EUROPEAN COMMUNITY POLICY: THE ECONOMIC ANALYSIS (Bruce Lyons ed., 2008) argued in a similar way that collusion in restraining capacity is hardly sustainable given the irreversibility of capacity investment decisions. However, there is a fundamental difference in the nature of the strategic interaction between the alleged colluding firms. When colluding in (irreversible) quantity/capacity decisions, firms anticipate that retaliation is not credible, as deviation in the form of irreversible capacity expansion would amount to strategic market preemption (similarly to entry deterrence), thus ruling out retaliation in the form of capacity expansion as a subgame perfect equilibrium, given that the competing firms would do better by accommodating in their capacity investments and losing market share, but remaining profitable. On the contrary, to host an MVNO would amount to deviation by undercutting rivals (although irreversibly), which would compel rivals to match the initial price cut, making the presumed retaliation mechanism the only subgame perfect equilibrium indeed. Technically speaking, the explanation for these opposite prescriptions is that quantity/capacity choices are strategic substitutes, whereas price choices are strategic complements.

to the defendants, the need to prove the market-distorting foreclosure effect rests on the plaintiff. Indeed, as it is explained in the next two parts, these two criteria are so deeply intertwined that such a neat allocation of the burden of proof would be bound to be problematic.[104]

In particular, this line of investigation calls into question the reasons (or the lack thereof)[105] for not including the additional requirement specific to the allegation of refusal to license intellectual property rights (IPRs) that "the undertaking which requests the licence does not intend to limit itself essentially to duplicating the goods or services already offered on this market by the owner of the IPR, but intends to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand."[106] Likewise, there seems to be no reason for dismissing that the prospect for the introduction of a new product could be a legitimate objective justification for the refusal to start supplying.[107]

In other words, the proposed reallocation of the burden of proof would be key to redressing the "natural bias" in favor of static allocative efficiency mentioned in the previous part. As discussed in detail in part III.A, the eventual incapability on the part of the could-be maverick firm would provide a rationale for designing optimal remedies that would minimize the expected costs of type I and type II errors.

The optimal remedies would be less restrictive (because of their reversibility) than imposing access obligations on the alleged colluding firms or deterring them from not granting access on a "voluntary" basis. As explained in part IV, the described irreversibility is crucial in reaching a sound understanding of how dynamic efficiency may be

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[104] This may be particularly true in light of the principle of unitary analysis under article 2 of Regulation 1/2003. *See* Int'l Bar Assoc., *supra* note 23, at 12.

[105] *See* PADILLA & O'DONOGHUE, *supra* note 22, at 449. For an opposite view, i.e., that the "special protection" for IPRs "based on 'innovation incentives' should be taken with a pinch of salt," see Cyril Ritter, *Refusal to Deal and "Essential Facility": Does Intellectual Property Require Special Deference Compared to Tangible Property?*, 28 WORLD COMPETITION 281 (2005).

[106] Discussion Paper, *supra* note 9, at ¶ 239.

[107] *See* PADILLA & O'DONOGHUE, *supra* note 22, at 451.

forestalled thus resulting in socially costly false positives from inappropriate intervention under article 82 of the EC Treaty.

III. REDRESSING THE REVERSAL OF THE BURDEN OF PROOF

Generally, there is a consensus among European enforcement agencies that a correlation exists between the retail level of competition and the presence of an MVNO.[108] Therefore, it is argued that the absence of an MVNO signals a tacit collusive agreement at the wholesale level in order to protect extra rents at the retail level.[109] As explained in the previous part, this position substantiates the logical forcing that occurs when erroneously applying the *Airtours* test to a practice of refusal to start supplying. In order to redress this fallacy, the competition or regulatory authorities should instead thoroughly assess whether the observed refusal is a rational and independent decision consistent with a firm's unilateral incentives. On a subsidiary basis, the investigation should focus on the competitive restraints posed by actual or potential competitors outside the alleged collusive agreement and thus the degree of indispensability of the alleged essential facility,[110] so as to avoid the presumption of anticompetitive

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[108] *See* European Commission, Public Consultation on a Draft Commission Recommendation on Relevant Product and Service Markets, at 40 SEC(2006) 837 (June 28, 2006); and Cave, Stumpf & Valletti, *supra* note 85, at 91; and European Regulators Group, *supra* note 41, at 21.

[109] *See* European Commission, *supra* note 108.

[110] In this respect, it is worth noting that the unavailability of spectrum frequencies as an insurmountable entry barrier was not a robust argument, as spectrum which could be used to provide mobile services has been generally unassigned, or available as not utilized, in all those countries where allegations of joint dominance have been arisen. Moreover, the presence of scale economies does not imply an insurmountable entry barrier to the extent that the average number of stable MNOs active in European countries is also four to five in medium and small markets (i.e., Netherlands, Greece, Austria, and Denmark). *See* Press Release, Ministro de Industria, Turismo y Comercio (June 6, 2005) (on file with author); Press Release, ARCEP, L'ARCEP prépare le lancement d'un appel à candidatures pour l'attribution de la quatrième licence mobile 3G (Nov. 23, 2006), *available at* http://www.arcep.fr/index.php?id=8571&tx_gsactualite_pi1%5buid%5d=895&tx_gsactualite_pi1%5bannee%5d=&tx_gsactualite_pi1%5btheme%5d=&tx_gsactualite_pi1%5bmotscle

foreclosure effects as a consequence of the observed pent-up demand.[111] What follows discusses this subsidiary line of investigation in detail.

A. The third Airtours *criterion and the perfect maverick*

The third *Airtours* criterion requires that competitive constraints not jeopardize the implementation of the common strategy underpinning the tacit collusive agreement. In particular, the likelihood of successfully enforcing a tacit collusive scheme is grim when there is an outsider competitor that manifestly has the incentives and capabilities to disrupt it. In this respect, the following definition of a maverick firm is adopted:

> It is sometimes asserted that a particular firm acts as a "maverick" that discourages any attempt to sustain collusion. . . . [T]his is in line with the economic intuition according to which "it is easier to collude among equals." . . . Consider for example a firm that has a drastically different cost structure, production capacity or product quality, or that is affected by different factors than the other market participants. . . . Alternatively, a firm may have a stronger preference for the short term and be therefore more tempted to undercut the rivals. The existence of such a "maverick" clearly tends to make collusion difficult if not impossible to sustain.[112]

As anticipated in the previous part, the presence of a maverick firm would strongly indicate that the absence of wholesale transactions demonstrates a noncoordinated equilibrium. In particular, as its com-

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%5d=&tx_gsactualite_pi1%5bbackID%5d=26&cHash=5e97bad520; Autorità per le Garanzie nelle Comunicazioni, at 50, Delibera n. 46/06/CONS, part 3.1.6., *available at* http://forum.europa.eu.int/Public/irc/infso/ecctf/library?l=/italia/adopted_measures/it20050259/mercato_decisione/decisione_finalepdf/_IT_1.0_&a=d; Commission for Communications Regulation, Market Analysis—Wholesale Mobile Access and Call Origination, ¶¶ 4.117–118, *available at* http://forum.europa.eu.int/Public/irc/infso/ecctf/library?l=/ireland/registeredsnotifications/ie20040121/comreg04118doc/_EN_1.0_&a=d; and European Commission, Comments Pursuant to Article 7(3) of Directive 2002/21/EC, Case MT/2006/0443 (Aug. 10, 2006), at 7, *available at* http://circa.europa.eu/Public/irc/infso/ecctf/library?l=/commissionsdecisions/commission_decisions_3/mt-2006-0443_cis-final/_EN_1.0_&a=d.

[111] *See* Elhauge. *supra* note 61, and Fox, *supra* note 61.

[112] *See* Ivaldi et al., *supra* note 49, at 55.

petitive constraints would also be exerted at the wholesale level, its presence would signal that such an outcome is plausible and legitimate even where downstream competition was imperfect. In this respect, the 3G-only MNO may play this role, as tacit collusive agreements in market 15 have usually been framed among 2G-3G MNOs, in particular, with reference to their refusal to start supplying access to their GSM networks.[113] The 3G-only MNO has usually been the latest entrant in the market, where its 3G business constituted a greenfield project, rather than being based on existing 2G operations as for GSM incumbents.

In what follows I argue that 3G-only MNOs do actually fit this role, as evidenced by assessing their compliance with each characterizing feature listed in the passage quoted above, specifically: 1) asymmetry in the cost structure; 2) asymmetry in the capacity restraint; 3) product differentiation; and 4) strong preference for the short term.

1. ASYMMETRY IN THE COST STRUCTURE It is generally established that cost asymmetries hinder the emergence of tacit collusive scheme, as the low-cost firm has more to gain from deviation and less to lose from retaliation.[114] At first sight, a 3G-only MNO would appear to have a cost disadvantage compared to incumbent GSM MNOs for three reasons: 1) being the later entrant, its network coverage is only partial, thus smaller than for other MNOs; 2) it faces higher

[113] In Ireland, the Commission for Communications Regulation initially designated O2 and Vodafone (both 2G/3G MNOs) as jointly dominant, whereas it deemed Meteor (2G-only MNO) and H3G (3G-only MNO) as being outside the tacit collusive scheme. In Italy, the NCA alleged that TIM, Vodafone and Wind (all 2G/3G MNOs) formed a tacit collusive scheme, whereas H3G (3G-only MNO) was not part of it. The Spanish NRA included all incumbents Telefónica Móviles, Vodafone and Amena (all 2G-3G MNOs) within the collusive scheme, whereas the threat/prospect of entry of a fourth 3G-only MNO, Xfera, was reckoned as ineffective in impeding the incumbents' coordination. In France, ARCEP alleged that all three 2G/3G MNOs (SFR, Orange and Bouygues Télécom) were jointly dominant, while being in the process of awarding a fourth 3G-only license. Similarly, the Maltese regulatory authority, MCA, concluded that the two GSM incumbents Vodafone and Go Mobile were jointly dominant while a third operator had requested frequencies for the roll-out of a 3G-network.

[114] *See* Ivaldi et al., *supra* note 49, part 9.

infrastructural costs to build up its network; and 3) its wholesale offer would eventually be subordinated to the terms of trade it is subjected to in its national roaming agreement, at least for the portion of territory not directly covered by its own network.[115]

However, at close scrutiny these arguments are weak, as the first alleged impediment is easily surmountable, given the possibility of reselling national roaming.[116] The second one is misleading, as it doesn't consider the relevant cost configuration in light of an eventual wholesale offer, so that the third argument does not necessarily result in a cost disadvantage.

To the extent that the 3G-only MNO has not yet reached full coverage, so that it has to make use of national roaming, its wholesale unit cost profile would be *blended* between the unit costs of wholesale access provision over its proprietary universal mobile telecommunications system (UMTS) network and the unit price it pays for national roaming over a GSM network.[117]

As regards the first element, to argue that a 3G-only MNO would be disadvantaged because of its higher infrastructure investments and its shorter amortization period is misleading, as the economic conditions of a hypothetical wholesale offer are to be assessed in line with the principles of the incremental and differential analysis. In other words, the analysis should focus only on those cash flows that are the consequence of the wholesale economic activity. Therefore, the circumstance that the 3G-only MNO has recently undertaken higher (if

[115] For the moment, it is assumed that there are no contractual restraints that would limit the 3G-only MNO from availing itself of reselling national roaming to hosted MVNOs. This issue is dealt with in part III.B.

[116] *See* European Commission, Comments Pursuant to Article 7(3) of Directive 2002/21/EC–Case IE/2004/0121 (Jan. 20, 2005), at 7, *available at* http://circa.europa.eu/Public/irc/infso/ecctf/library?l=/commissionsdecisions/commission_decisions_2/2004_0121_publicpdf/_EN_1.0_&a=d ("Even if fringe competitors were not able to exert a competitive constraint at the retail level, they may be able to do so at the wholesale level . . . as a result of the national roaming agreement . . . , one of the fundamental conditions to be able to offer national coverage to an MVNO may now have been fulfilled.").

[117] Commonly, national roaming over the 2G network is introduced as an asymmetric regulatory measure supporting the 3G-only MNO's entry.

ever) infrastructure investments is irrelevant, as these costs are sunk, i.e., already incurred and irreversible (at least in light of the wholesale activity concerned) and thus nonincremental to the supply of wholesale access. Moreover, the circumstance that the 3G-only MNO has yet to undertake higher (if ever) infrastructure investments, in order to reach full coverage, is equally irrelevant, as these would have been undertaken regardless of the wholesale economic activity concerned and are thus nondifferential.[118]

Therefore, instead of referring to a notion of average cost, inclusive of fixed and common infrastructure investments, the relevant configuration should be of average variable costs, as long as these are incremental and differential to the wholesale provision of access and origination services.

Regarding the unit price paid for national roaming, it can be further split between the average variable cost of wholesale access provision over a GSM network and the wholesale profit mark-up on top of it.[119] The allocations would equal, respectively, the actual coverage percentage of the proprietary UMTS network and its complement.

This modelling choice is not just conventional, as it is respondent to the relative cost profiles of both supply solutions. As the UMTS technology is more efficient than the GSM technology, the average variable cost implied by the former would be lower than that of the latter.[120] This would be particularly so in light of the wholesale profit mark-up on top of the latter. Therefore, the identified allocations

118 It is worth noting that this is not necessarily the same for incumbent GSM MNOs. *See* European Commission, Comments Pursuant to art. 7(3) of the Framework Directive—Case ES/2005/0330, *supra* note 74, at 9 ("The Commission notes that the networks of all three MNOs are dimensioned to support only forecasted traffic in the short to medium term. However, according to CMT, all three MNOs appear to have sufficient spectrum enabling them to adapt rapidly the capacity of the network to the evolution of the traffic.").

119 Even though national roaming has not usually been mandated on a cost basis, in all concerned countries it is upon the supplying incumbent not to unfairly discriminate against the 3G-only MNO.

120 *See* Office of Communications (UK), Mobile Call Termination ¶ 9.14 (Mar. 27, 2007), *available at* http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/statement.pdf.

would be consistent with both the principles of cost minimization and profit maximization.[121]

However, given the above mentioned wholesale mark-up on national roaming, the blended cost profile of the 3G-only MNO might still be higher than the average variable cost of provision of wholesale access for the incumbents, thus implying a cost disadvantage for the latter. In this respect, it is possible to identify a percentage floor to the profit mark-up thereof, below which the 3G-only MNO would instead enjoy a cost advantage against the incumbents in the provision of wholesale access to MVNOs. Therefore, for the cost profile of the 3G-only MNO to be comparable to the incumbents', the following equation must be satisfied:

$$Cov\%AVC_{UMTS} = (1 - Cov\%)(1 + \pi)AVC_{GSM} = AVC_{GSM}\,; \qquad (1)$$

where $Cov\%$ is the 3G-only MNO's UMTS coverage, and AVC stands for average variable cost. Therefore, the wholesale mark-up's floor is given by:

$$\bar{\pi} = \frac{Cov\%\Delta}{(1 - Cov\%)\,AVC_{GSM}}\,; \qquad (2)$$

where Δ is the positive difference between the UMTS and GSM average variable costs.

A valid proxy for the average variable costs of provision of wholesale access over a UMTS and a GSM network is provided by the analysis conducted by the UK regulatory authority, Ofcom, of the

[121] The same line of reasoning has been applied by the UK NRA, Office of Communications (Ofcom), in its endorsement of the principle of technology neutrality for the definition of a single 2G/3G blended mobile call termination charge. *Id.* at ¶ 9.20 ("Ofcom has concluded therefore that a single charge control to apply to a given operator without distinction of the network used to supply MCT is appropriate and consistent with Ofcom's duties. It would provide appropriate incentives for operators to invest in and migrate traffic to the most efficient network, i.e. that with the lowest unit costs, such that cost minimisation and (constrained) profit maximisation are congruent. In Ofcom's view, a single technology-neutral control would also provide operators with appropriate incentives to invest in and utilise the lowest-cost technologies to the benefit of end users.").

costs of mobile voice termination over both a GSM and a UMTS platform.[122] In particular, Ofcom developed a bottom-up economic model to estimate the long run incremental cost (LRIC) of mobile voice termination, whereby the 2G and the 3G costs were estimated to be, respectively, 5.45 and 3.94 eurocents per minute.[123] Therefore, the average variable costs of provision of wholesale access over an UMTS and a GSM network can be assumed to be equal to twice the corresponding termination charge. This multiple is in line with the European Commission's original proposal for international roaming regulation, where the wholesale floor for a "within-country call" was set equal to twice the average European MCT for operators with SMP.[124] It is worth nothing though that the chosen multiple doesn't define the wholesale mark-up's floor, as what matters is the relative spread between the 2G and the 3G costs.[125]

Even though this estimation is meant to give just an order of magnitude of this threshold, it nevertheless allows a reasoned assessment of the competitiveness of an eventual commercial offer from the 3G-only MNO, even if subjected to the commercial terms of its national roaming arrangement. For example, as soon as its coverage exceeds 40%, it would still be competitive even with a wholesale mark-up as high as 20%, as shown in figure 2.

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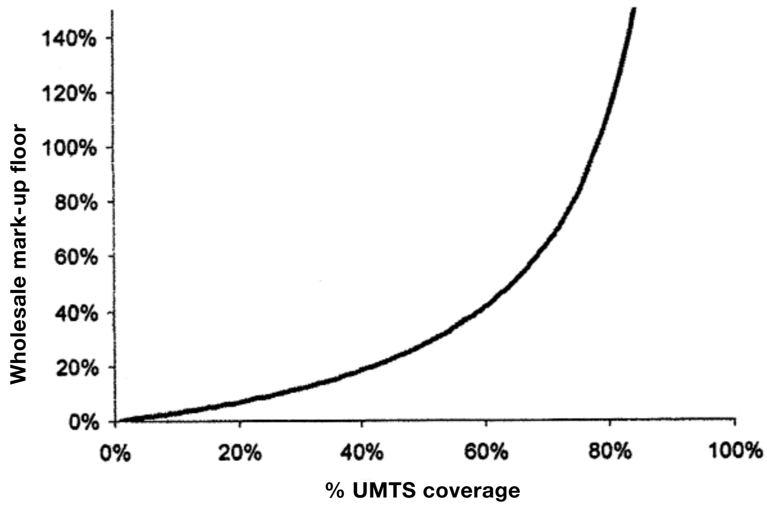
122 *Id*.

123 These figures correspond to the 2010–2011 LRIC of mobile voice termination in real 2006–2007 prices and before the 3G license fee allowance. *Id.* at figure A13.1.

124 *See Commission Proposal for a Regulation on Roaming on Public Mobile Networks within the Community*, at 6 COM(2006) 382 final 2006/0133 (COD) (July 12, 2006).

125 As the Ofcom model assumed that both infrastructures would operate as full-scale regimes in 2010–2011, these cost configurations are an appropriate proxy for the spread between the average variable costs of wholesale access provision over the 2G and the 3G networks. Furthermore, as both LRIC costs equally comprised a mark-up for nonnetwork costs and an externalities surcharge, the resulting estimation of the relative spread is conservative.

Figure 2
The Wholesale Mark-up Floor as a Function of the UMTS % Coverage



2. ASYMMETRY IN THE CAPACITY RESTRAINT Access networks exhibit scale economies until coverage capacity is not yet saturated, so that below a certain traffic threshold (i.e., minimum efficient scale (MES)) average total costs decrease as coverage fixed costs are spread over higher traffic volumes. Given the lower market share, the 3G-only MNO would be far from having exhausted its coverage capacity, at least in comparison to the GSM incumbents. Therefore, the 3G-only MNO would have more unutilized transmission capacity than its GSM incumbents, that is, capacity already deployed and not yet saturated.[126] Moreover, even if the 3G-only had the same market share as the incumbents, it would still have more available capacity, given the higher (spectral) efficiency of the UMTS technology.

3. PRODUCT DIFFERENTIATION As mentioned in the previous part, the unilateral incentive to open to an MVNO strongly depends on the degree of retail cannibalization—the greater the capacity of the hosted operator to differentiate its market position from the hosting MNO's, the larger the latter's incentive to supply wholesale access to its

[126] *See* EMMA BUCKLAND & WINDSOR HOLDEN, STRATEGIES FOR MVNOS ¶ 2.4 (2007), *available at* http://www.analysys.com.

network. In this regard, the 3G-only MNO was distinctively positioned as the pioneer of the next generation mobile services, thus primarily targeting so-called "enthusiast" adopters.[127] This product positioning would allow the 3G-only operator to shun direct cannibalization by profiling its hosted MVNO as a 2G-only one. In particular, the hosted MVNO could position itself at the opposite extreme of the attribute map, by selling a budget mobile product focused on traditional voice and data services, i.e., so-called "no-frills" MVNOs. This way, the 3G-only operator should suffer the least from retail cannibalization while earning wholesale margins at the expense of its GSM incumbents.[128]

No-frills products are generally distributed via a Web site and through a branded subscriber identity module (SIM), thus reducing overhead. Prepaid service, which complements this approach, is the preferred charging mechanism, as the prepaid service platform is considerably easier to churn from than post-paid, as invariably the customer owns the handset and is less likely to have a subsidized (SIM-locked) handset. Discounting is the primary service differentiator.[129] Alternatively, commercialization may be through retail and point-of-sale distribution channels, where the MVNO retailer's strength lies in its ability to simplify and facilitate impulse purchases. In particular, prepaid is a desirable service offering for the retailer MVNO, as it requires repeated interaction with a point-of-sale terminal.[130]

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127 The main example is provided by H3G, whose marketing proposition has always been peculiarly (and, as it is explained later on, necessarily) innovative. *See* Hutchison 3G UK Limited, http://www.three.com/.

128 Such a contractual arrangement would not give rise to anticompetitive concern, as the 3G-only MNO is usually far from having a dominant position in the mobile access and origination market both at the retail and, a fortiori, at the wholesale level.

129 *See* Informa, *MVNO Strategies and Forecasts to 2011: Evolving Opportunities in the Global Telecoms Marketplace* 113 (Jan. 2007), *available at* http://www.mindbranch.com/MVNO-Strategies-Forecast-R443-238/.

130 A prominent example is provided by the retailer and discount MVNO service provider Tesco, which has segmented its MVNO service offering by using its "Tesco Value" retail brand as a subbrand to offer "super-discounted" mobile rates. Tesco Mobile acquired 671,200 new subscribers between the second quarter of 2005 and the third quarter of 2006, the largest growth in terms of subscribers of all the tracked UK MVNOs. *Id.* at 261.

It may be argued that such a wholesale strategy isn't plausible, as the hosted MVNO would struggle to churn consumers, given their need to get (if they do not already possess) SIM-free 3G handsets first, which are generally more expensive than 2G ones. In this respect, it is worth noting that the price differential between 2G and entry-level 3G handsets is shrinking[131] and will continue to shrink in the future.[132] Moreover, the MVNO could opt to subsidize the entry-level 3G handset, as an effective consumer acquisition strategy.

This would be particularly so in case of a retailer MVNO, whereby the focus is on the creation of synergies between existing offerings and mobile service offerings, in order to increase the average expenditure of the existing customers, i.e., "one-stop shopping." In this approach, the MVNO operation does not necessarily need to be directly profitable, as it is being used to increase consumers' loyalty and thus overall profitability: the MVNO acts as a loss-leader.[133]

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[131] This is particularly due to increasing competition from Indian and Southeast Asian vendors that are exerting pricing pressure on Western European and American incumbents, in particular, for voice-centric handsets. *See* Yanli Suo-Saunders, *Evolution of Mobile Handsets to 2011 and Beyond: Market Analysis and Forecast* 14 (Analysys, July 2006), *available at* http://www.analysys.com. For example, Vodafone's 710 and O2's Ice phones are both considerably cheaper than existing 3G handsets. Both of these phones were manufactured under ODM agreements with, respectively, Huawei and Pantech & Curitel. *See* Ovum, *O2 Ice: a Mass-market 3G Device* (Oct. 2006), *available at* http://www.ovum.com/go/content/s, 67277 and Press Release, Huawei, Huawei Announces 500,000 Vodafone 710s 3G Phones Now Sold (Feb. 14, 2007), *available at* http://www.huawei.com/news/view.do?id=3085&cid=42.

[132] This trend is exemplified, for example, by the "3G for all" campaign championed by the GSM Association, which aims at making third-generation mobile services accessible to a much wider user base. *See* Press Release, GSMA, LG Handset to Lead GSMA's "3G for all" Campaign (Feb. 12, 2007), *available at* http://www.gsmworld.com/news/press_2007/press07_15.shtml; and Ovum, *'3G for all': The First Step* (Nov. 2006), *available at* http://www.ovum.com/go/contents/s, 67291. In this respect, the Korean vendor LG has recently launched its 3G for all candybar priced at €80, with a 1.3 megapixel camera, MP3 and video player. *See* Ovum, *3GSM: A Device Vendor Round-up* (Mar. 2007), *available at* http://www.ovum.com/go/content/s, 69473.

[133] Tesco Mobile in the UK with its "Tesco Value" brand is the prominent example. Informa, *supra* note 129, at 140.

However, it is worth noting that the hypothetical 3G no-frills MVNO would usually be the first MVNO to enter the market, being capable of undercutting other 2G eventual followers, given the cost advantage inherited by the 3G-only MNO.[134] Therefore, this profile suggests that such a virtual operator could be commercially successful while still maintaining financial viability.

4. STRONG PREFERENCE FOR THE SHORT TERM A tacit collusive agreement is sustainable if and only if firms put sufficient weight on future profits, i.e., if their discount factor is not too small.[135] Therefore, the presence of a competitor characterized by an asymmetric discount factor hinders the emergence and sustainability of a tacit collusive scheme.[136] Arguably, "short-termism" might be present when financial stability is strained—firms in financial difficulties tend to have a preference for short term performance.[137] This tendency may be further strengthened by pressure exerted by financial markets.[138]

In particular, while being the smallest MNO in the market, the 3G-only MNO must undertake relatively larger infrastructure investments to build up its proprietary UMTS network, in order to reach comparable coverage. Therefore, the 3G-only operator should be the

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[134] From the consumer's perspective, such a proposition can be framed as a two-part tariff, where the handset cost is the fixed element, eventually subsidized. Therefore, in comparison with an equivalent 2G handset-SIM discount package, the 3G package would offer a higher fixed fee and a lower usage fee, thus being preferable above a certain usage threshold.

[135] *See* Ivaldi et al., *supra* note 49, at 8.

[136] *See* Joseph Harrington, *Collusion Among Asymmetric Firms: The Case of Different Discount Factors*, 7 INT'L J. INDUS. ORG. 289 (1989).

[137] *See* Peggy Hsieh, Timothy Koller, & S. R. Rajan, *The Misguided Practice of Earnings Guidance*, MCKINSEY ON FINANCE, Spring 2006, at 1.

[138] The quintessential 3G-only MNO active in Europe is H3G, whose financial stability was questioned by financial markets. In particular, H3G abandoned its initial public offering in Italy, where it could not reach its target price, and has ceased to publish financial targets in the UK. *See* Ovum, *3 Group—The Road to Profitability Still Looks Very Bumpy* (Mar. 2007), *available at* http://www.ovum.com/go/content/s, 69847; and Office of Communications, *supra* note 120, at ¶¶ A14.53–54.

most eager to earn the wholesale margins from hosting an MVNO and thus contribute to its infrastructure investments.[139]

5. THE PERFECT MAVERICK Concluding this analysis, the idiosyncratic profile of the 3G-only MNO demonstrates its incentives and capabilities to (unilaterally) supply wholesale access to virtual operators, thus eventually preventing the emergence of a tacit collusive scheme among 2G-3G MNOs. In other words, the 3G-only MNO would resemble the perfect maverick.

Therefore, the circumstance that the 3G-only MNO also refused to start supplying wholesale access to MVNOs would be strongly indicative that the observed wholesale status quo without access transactions was the noncoordinated outcome of all MNOs' unilateral decisions,[140] even though downstream competition was (statically) imperfect.[141] As explained in the previous part, to focus the competi-

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[139] *See* Informa, *supra* note 129, at chap. 7.

[140] Otherwise, the 3G-only MNO should be considered as part of the tacit collusive agreement, and the wholesale relevant market should be enlarged to comprise all UMTS network infrastructures. This would be problematic in that the investigator might commit an error of circularity where a particular course of conduct, which could be consistent with both anticompetitive and competitive outcomes, is unambiguously taken as evidence of collective dominance. *See*, *e.g.*, ARCEP, Public consultation on the national market for access and origination services on public mobile telephone networks 87 (2005) ("[T]he credibility [of the envisioned retaliatory measure] has been strengthened by the behaviour of Bouygues Telecom . . . which, while having a greater interest than its competitors in hosting MVNOs on its network, has thus far failed to do so, and appears, moreover, to be absent from the recent negotiations with prospective MVNOs.").

[141] In this respect, it is nevertheless insightful to quote a passage from H3G's comments to the European Commission's proposal for reviewing the ECNS Regulatory Framework:

> The analysis of the market provided in the draft revised Recommendation shows clearly that the Commission sees the presence of MVNOs as the primary indicator of the competitiveness of a market. The absence of MVNOs in contrast requires regulation, with the appropriate remedy being enforced MVNO access.
>
> This is flawed logic. Whilst MVNOs are often present in competitive mobile markets, it is not a necessary condition (nor indeed a

tive assessment on the third rather than the second *Airtours* criterion would prevent the investigator from falling into the non sequitur fallacy where the absence of upstream transactions in a vertically integrated tight oligopoly is wrongly taken as an unambiguous piece of evidence of upstream joint dominance. Otherwise, as it is demonstrated in part IV, there would be a high risk of committing type I errors, whose costs would distort dynamic efficiency. Moreover, as explained in the rest of this part, this counterintuitive approach would enable enforcement agencies to eventually envisage an optimal remedy that would minimize the risk of inappropriate intervention in the application of article 82 of the EC Treaty to alleged exclusionary practices.

B. The perfect maverick and the optimal remedy

In the previous section, it was assumed that the 3G-only MNO would be able to resell national roaming in order to host virtual operators in the absence of any contractual impediment. However, in case such a restraint was in place, an available positive behavioral remedy would be to relieve this impediment, in order to enable a 3G-only MNO to compete for wholesale business whenever it would find this option unilaterally profitable. This part argues that such a remedy would be less restrictive than the alternative of forcing GSM incumbents to supply wholesale access. In particular, the enforcement of the latter alternative may result either from a direct interven-

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> sufficient condition) for a competitive market. The application of this flawed approach led the Irish regulator, ComReg, to require Vodafone and O2 to offer MVNO access at a time when Meteor and 3 Ireland were just entering the market. The remedy may have led to greater service level competition but would have harmed the prospects for long term sustainable infrastructure competition. Given the widely recognized superiority of infrastructure competition, this remedy would not have been in the interests of Irish citizens.
>
> Fortunately, ComReg's market review was withdrawn following an appeal.

H3G, 3 Group's response to the Commission's consultation on the review of the telecoms regulatory framework 5 (2006), *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/info_centre/public_consult/relevant_markets_2/comments/3_group.pdf.

tion aimed at mandating an access obligation to MNO incumbents,[142] or, indirectly, through deterrence.[143]

The comparative assessment between these two alternative remedies can be properly conducted in light of the decision theoretic framework. According to this approach, a legal rule partitions observed practices into two categories: those that are legal under the rule and those that are illegal. However, as rule enforcement is inherently imperfect, this categorization is not necessarily (or better, never) coincident to the partition between harmful and benign practices. Therefore, by crossing over these two partitions it is possible to define two types of errors ensuing from inappropriate intervention: false conviction of a benign practice (or, type I error); and false acquittal of a harmful practice (or, type II error). The decision theoretic framework posits that the optimal conformation of a legal rule should tend to minimize the expected sum of both types of error costs.[144]

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[142] Access obligations have been imposed in several Western European countries, namely, Norway in 1998; Denmark and The Netherlands in 1999; Denmark in 2000; and Spain and Malta in 2006. *See* European Regulators Group, *supra* note 41; and BUCKLAND & HOLDEN, *supra* note 126.

[143] As regards the moral suasion exerted by NRAs in forcing access transactions in market 15, see Discussion Paper, *supra* note 9, at 21 ("The vast majority of the agreements on SP and MVNO access are based on commercial negotiations. The "threat" of a potential regulation may however not be ruled out as a means of rendering these commercial agreements possible and may, in some cases, play an important role."). For a general discussion of the undue deterrence exerted by competition authorities even when firms reach a voluntary agreement, see Jordi Gual, et al., *An Economic Approach to Article 82*, at 46 (Econ. Advisory Group for Competition Pol'y, 2005), *available at* http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf. A concrete example is provided by the recent wholesale agreements entered into by Vodafone Italy with the Italian Postal Office, Poste Italiane, and the retailer Carrefour. In particular, these deals come after the NCA, AGCM, invited comments on commitments by Vodafone to host an MVNO on its network in relation to the above-mentioned competition law inquiry against the three GSM incumbents. *See* AGCM, A357—Tele2/Tim-Vodafone-Wind (Provvedimento n. 16380, 2007), *available at* http://www.agcm.it/agcm_ita/docum/Impegni.nsf/0/04945c28ee5ff534c12572720031861c/$FILE/P16380S.pdf.

[144] Costs are measured in terms of the social welfare loss caused by the inappropriate decision. *See* OFT, The Cost of Inappropriate Intervention/Non-

As a remedy would eventually be imposed only in case of conviction, the assessment can start focusing only on the expected costs from an inappropriate conviction of the incumbent MNOs for abuse of collective dominance under article 82 of the EC Treaty (or, a finding of joint SMP within the ECNS Regulatory Framework), in the form of refusal to start supplying wholesale access to their mobile networks.

As explained in the previous section, the 3G-only MNO is argued to be the perfect maverick at the wholesale level, thus potentially having the greatest incentives to host virtual operators, so that its eventual refusal to supply wholesale access would indicate that the absence of wholesale transactions was consistent with a noncoordinated equilibrium rather than the enforcement of tacit collusion. Therefore, the remedy proposed would be the least restrictive possible, as it would minimize the expected cost from a false conviction. Indeed, it would nullify type I error costs, as it would be left to the perfect maverick to directly assess whether or not it would be unilaterally profitable to supply upstream to independent downstream competitors. Therefore, to remove any existing contractual constraint impeding the 3G-only MNO from supplying wholesale access would nullify the occurrence of type I errors. Moreover, by applying this remedy a priori, the enforcement agencies would nullify even the likelihood of incurring type II errors. Concluding, the proposed positive behavioral remedy would be the optimal remedy, as it would nullify the occurrence of both type I and II errors, thus zeroing their expected costs.

Therefore, this remedy would be superior to the alternative remedy of (directly or indirectly) imposing access obligations on the incumbent MNOs, as under this more restrictive alternative there would be a positive likelihood of incurring type I errors, given the information asymmetry that would adversely affect any intervention—setting aside the risks of making erroneous circular inferences as described in part II. Moreover, as presented in the next part, the social welfare loss due to the occurrence of type I errors could be significant given the irreversibility of imposing access obligations.

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interventions under Article 82 (OFT864, 2006), ch. 1, *available at* http://www.oft.gov.uk/advice_and_resources/resource_base/economic-research/completed-research.

IV. THE COST OF INAPPROPRIATE INTERVENTION UNDER ARTICLE 82 OF THE EC TREATY

As explained in part I, inappropriate intervention under article 82 of the EC Treaty might result from a natural bias in favor of ex post incentives to improve allocative efficiency, thus sacrificing ex ante incentives to continuously advance dynamic efficiency. This consideration suggests researching the reasons why MVNOs might forestall the achievement of dynamic efficiency in the mobile industry. In this respect, the analysis developed in the previous part provides useful insights. The circumstances under which a 3G-only operator unilaterally refused to start supplying wholesale access to MVNOs, even though it should have a comparatively large incentive to do so, would suggest that the presence of MVNOs might forestall its efforts to commercially promote the mass adoption of 3G. If this was the case, the investigative shortcuts described in this article would have prevented enforcement authorities from fully capturing the competitive dynamics shaping the mobile industry.[145]

[145] It is worth noting that the European Commission repeatedly signalled the importance of actual or potential 3G-only operators in increasing competitive intensity at the retail level. For instance, regarding the Irish case the Commission noted that "ComReg should monitor the effective developments of the emergent competitors Meteor and '3' very closely in the near future and, when appropriate, review its SMP analysis and the regulatory measures imposed. In case these competitors prove capable of gaining retail market share rapidly and at the expense of Vodafone and O2, one of the criteria which currently imply collusive behaviour by these two operators may no longer be met." European Commission, s*upra* note 116. In reference to the Italian notification, the Commission stated that "[t]he further information supplied to the Commission by AGCOM shows that i) the third MNO (in terms of market share) has decreased prices in a considerable manner in 2004 and its prices are no longer aligned with the prices of the first and second MNOs, and that ii) the fourth MNO has increased its market share, to the detriment especially of the larger MNOs. . . . [T]he Commission strongly recommends and invites AGCOM to closely monitor the market so as to identify whether the market irreversibly tends towards a competitive structure in which any tacitly co-ordinated outcome is unlikely to happen." European Commission, Comments Pursuant to art. 7(3) of the Framework Directive—Case IT/2005/0259, at 4 (Nov. 9, 2005), *available at* http://circa.europa.eu/Public/irc/infso/ecctf/library?l=/italia/registeredsnotifications/it20050259/2005

In other words, it could be argued that although the absence of wholesale transactions was not due to a tacit collusive agreement among incumbents (thus being legitimate), intervention would nonetheless be socially beneficial as promoting the entry of MVNOs, which would put downward pressure on prevailing retail prices.[146] However, this argument would be incomplete in that the inappropriateness of a false positive would depend on the extent

_0259_greffepdf/_EN_1.0_&a=d. Similarly, for Spain, "[t]he Commission emphasises that the fourth network licence was already granted in March 2000 to Xfera but the company has not yet entered the market. The Commission invites the Spanish authorities to explore appropriate measures in order to ensure efficient use of the available spectrum with a view to enhance competition in the retail market. CMT should closely monitor the effects of a possible entry of Xfera in 2006 on the future sustainability of the collectively dominant position. Any concrete evidence of developments in the retail market not linked to the regulatory measures in the relevant market that would cast doubt on the sustainability of the collectively dominant position will require a review of the relevant market." European Commission, *supra* note 74. And, finally, in commenting on the notification from the Maltese regulatory authority, "[t]he Commission notes that a third operator has requested frequencies and invites MCA to monitor closely the impact of a possible market entry of a third operator on the future sustainability of the collectively dominant position. Any concrete evidence of developments in the market not linked to the regulatory measures imposed that would cast doubt on the sustainability of the collectively dominant position will require a review of the relevant market." European Commission, *supra* note 110. However, the European Commission did not recognize the irreversibility of the proposed remedies, which could have forestalled the transition towards the next-generation of mobile services.

146 *See, e.g.*, Dewenter & Haucap, *supra* note 40, at 322 ("From a policy perspective, our findings imply that firms may not always voluntarily grant MVNO access as the simple Cournout model would predict. If firms compete in prices or if firms move sequentially (which may not be too bad a reflection of reality, given that licenses to operate mobile telecommunications networks have been granted sequentially in almost all jurisdictions), MNOs may not face proper incentives to host MVNOs. This means that even in the absence of any collusive behaviour firms may find it individually rational (i.e, profit maximizing) not to grant MVNO access. . . . In this case, there may be a role for regulatory intervention in order to boost competition.").

to which the welfare losses from forgone dynamic efficiency dominate the welfare gains from increased allocative efficiency that result from the presence of MVNOs in the market.[147]

In this respect, it is conventionally argued that welfare losses from dynamic efficiency are typically due to reduced investment incentives for incumbents, thus implying an ex ante perspective.[148] Accordingly, in the Discussion Paper, a refusal to start supplying could be (objectively) justified in that "[i]n order to maintain incentives to invest and innovate, the dominant firm must not be unduly restricted in the exploitation of valuable results of the investment."[149] However, it is well established that, in the presence of demand-side network effects, dynamic distortions could arise in

[147] Øystein Foros, Bjøn Hansen, & Jan Yngve Sand, *Demand-side Spillovers and Semi-collusion in the Mobile Communications Market*, 2 J. INDUS. COMPETITION & TRADE 259 (2002), analyze the interdependence between voluntary and mandatory roaming agreements on the one hand, and cooperative and noncooperative investment in network coverage on the other. However, they deal with a two-way interconnection relationship rather than one-way as in the case of MVNO/ESP's entry. Byung Woon Kim & Sung Uk Park, *Determination of the Optimal Network Charge for the Mobile Virtual Network Operator System*, 26 ELECS. & TELECOMM. RES. INST. J. 665 (2004), research the optimal (linear) access charge between MNOs and MVNOs when the products offered are either complements or substitutes. However, they model an upstream monopoly rather than an oligopolistic setting.

[148] *See* Dewenter & Haucap, *supra* note 40, at 316 ("When calling for regulatory intervention, however, one should keep in mind that our model is a static one which does not consider investment, but assumes that the necessary infrastructure is given. If, however, investment incentives need to be considered as well (which is, of course, necessary from a dynamic efficiency perspective), the model presented here needs to be augmented. Therefore, we think that the integration of investment decisions into our model provides an interesting topic for further research."). *See also* Evans & Padilla, *supra* note 64.

[149] Discussion Paper, *supra* note 9, at ¶ 235. As a corollary and from an ex post perspective, "[t]he circumstances in which a refusal to supply by a dominant company may be abusive are therefore more likely to be present when it is likely that the investments that have led to the existence of the indispensable input would have been made even if the investor had known that it would have a duty to supply." *Id.* at ¶ 236.

the transition from the old to the new generation standard,[150] regardless of where the infrastructure platform was already in place:[151]

> Generally speaking, generation changes in network markets are affected by network effects because adopters take into account switching decisions of other adopters in their own decision. An adopter preferring a switch *ceteris paribus* may delay a decision until others have switched, which of course may delay a new technology emerging or, in the extreme, even shut it out completely. This socially undesirable persistence of the incumbent technology is often referred as excess inertia. Excess inertia typically requires a degree of consumer uncertainty and/or heterogeneity.[152]

It is worth remembering though that backward inertia has generally been researched in the context of incompatibility between the old and new standards, thus being primarily framed as a demand-side coordination failure among potential adopters (also labelled a "chicken-and-egg" problem). In this regard, the 2G and 3G technologies are compatible and thus close substitutes in the provision of basic mobile voice and data services. However, the 3G platform also supports the provision of new enhanced services, such as mobile Internet, music download and mobile TV, with which 2G handsets

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[150] *See* Joseph Farrell & Paul Klemperer, *Coordination and Lock-In: Competition with Switching Costs and Network Effects*, *in* III Handbook of Industrial Organization 2028 (Mark Armstrong & Robert Porter eds., 2007).

[151] Regarding the development of 3G mobile telephony, the majority of European operators purchased their UMTS licenses between 2000 and 2002. *See* Paul Klemperer, *How (Not) to Run Auctions: The European 3G Telecom Auctions*, 46 Eur. Econ. Rev. 829 (2002). Moreover, by 2005, nearly three-quarters of the planned frequency blocks were already in commercial use. *See* Stefan Heng, *UMTS Broadband Mobile Technology Rollout* 4 (Deutsche Bank Research No. 57, 2006), *available at* http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000199922.pdf. Nevertheless, it is worth remembering that, once the required network coverage is achieved, additional capacity is usually added incrementally in response to steady demand increases, thus giving rise to ex ante so-called real options when demand for the next generation of mobile services is uncertain. *See* Y. d'Halluin, P.A. Forsyth, & K.R. Vetzal, *Wireless Network Capacity Management: A Real Options Approach*, 176 Eur. J. Operational Res. 584 (2007).

[152] Heli Koski & Tobias Kretschmer, *Survey on Competing in Network Industries: Firm strategies, market outcomes, and policy implications*, 4 J. Indus. Competition & Trade 5, 11 (2004).

are (partly)[153] incompatible. Moreover, these enhanced services show strong network externalities, both of the direct (e.g., e-mail and social networking) and the indirect type (e.g., mobile TV, music download).[154]

Nevertheless, coordination failure could also be caused by supply-side distortions in the form of strategic pricing sponsorship,[155] whereby price competition focuses on those consumers that are pivotal for the transition process (typically labelled as "early" or "enthusiast adopters"). The failure to get those pivotal adopters "on board" may lead to backward excessive inertia.[156] The expression "on board" is intentionally reminiscent of the theory of two-sided markets—in the provision of content-related services, MNOs' networks are platforms that enable their consumer base to interface with third-party content providers.[157] A styl-

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153 These services may be available but with a degraded quality when compared to the full 3G standard. *See* Nielson Mobile, Critical Mass: The Worldwide State of the Mobile Web 7 (July 2008), *available at* http://www.nielsenmobile.com/documents/CriticalMass.pdf ("3G networks perform up to six times faster on data throughputs used for mobile Internet than 2G and 2.5G networks.").

154 *See* Nicholas Economides, *The Economics of Networks*, 14 INT'L J. INDUS. ORG. 673 (1996). In particular, the first category consists of pure-network goods, where there is no value to the good in the absence of (direct) network externalities (i.e., if the network's size is zero), whereas content-related services may have a stand-alone value, even in the presence of (indirect) network externalities. Moreover, while pure-network services are mainly substitutable with traditional voice and data mobile services, content-related services are mainly complementary.

155 *See* Farrell & Klemperer, *supra* note 150, at 2041.

156 Farrell & Klemperer distinguished between ex ante excessive early power, whereby early adopters have excess power if their preferences weigh too heavily (relative to later adopters) in the collective choice of what is adopted, from ex post excessive inertia, whereby "later adopters remain compatible with the installed base even though an alternative would be better if network effects were neutralized. The two are linked, in that the stronger ex post inertia will be, the more power early adopters have. However, given that the 3G technology is fully backward compatible with 2G (but not vice versa), ex post excessive inertia doesn't appear to be as constraining as ex ante excessive early power for the adoption process of the 3G platform." *Id.* at 2028.

157 In the case of peer-to-peer and social networking applications, consumers are both content users and providers.

ized fact of two-sided platforms delivering content-related applications is that the platform owner has to first build up a critical mass on the consumer side in order to trigger the supply of content on its platform. This diffusion pattern is typically illustrated via the "hardware-software paradigm"[158] common to the adoption process of content-related two-sided platforms such as video and music formats, game consoles,[159] PDAs[160] and mobile Internet.[161]

However, when deciding upon adoption, consumers face uncertainty about the variety and quality of their use of the 3G platform, i.e., 3G mobile telephony as an experience good,[162] and about the long term price that this use implies, i.e., adoption creating a hold-up problem. These features point to the need for MNOs to adopt a penetration pricing strategy to promote the adoption of 3G mobile telephony in that (1) the demand for hardware, i.e., 3G subscription and basic services, would be typically elastic with respect to price at the beginning of the cycle; and (2) given consumer uncertainty, a low introductory hardware price would signal the platform provider's confidence in, and commitment to, its success.[163] In this respect, as incumbent

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158 *See* Koski & Kretschmer, *supra* note 152.

159 *See* Matthew T. Clements & Hiroshi Ohashi, *Indirect Network Effects and the Product Cycle: Video Games in the U.S., 1994-2002*, 53 J. INDUS. ECON. 515 (2005).

160 *See* Harikesh Nair, Pradeep Chintagunta & Jean-Pierre Dubé, *Empirical Analysis of Indirect Network Effects in the Market for Personal Digital Assistants*, 2 QUANT. MKTG. & ECON. 23 (2004).

161 *See* Per E. Pedersen & Leif B. Methlie, *Exploring the Relationship Between Mobile Data Services Business Models and End-user Adoption*, *in* BUILDING THE E-SERVICE SOCIETY: E-COMMERCE, E-BUSINESS, & E-GOVERNMENT (W. Lamersdorf, V. Tschammer & S. Amager eds., 2004).

162 *See* Phil Taylor, *Consumer Mobile Media Survey—First Findings: Consumers Want But Will They Pay?* (Strategy Analytics, 2007), *available at* http://www.strategyanalytics.net/.

163 This aspect of the transition process is particularly crucial in this specific case, as up to the second generation of mobile telephony, user consumption had been mainly in the form of two-way services such as voice and short message service, whose value was typically due to direct network externalities. Therefore, the intergenerational transition toward the 3G mobile platform is more problematic compared to, say, game consoles, where users are

MNOs generally run both 2G and 3G networks, it should be in their interest to support the intergenerational transition process. Therefore, difficulties in adopting the new platform would come only from the demand side, due to consumers' failure to coordinate themselves.

However, the presence of MVNOs, whether directly or indirectly facilitated by regulatory or antitrust scrutiny, would alter the nature of this transition process. This is because MVNOs' entry pattern would overlap with the one typically adopted by 3G-only MNOs. In Europe, this would be particularly so with regard to so-called "no-frills" MVNOs, whose penetration strategy would typically consist of offering volume discounts for basic voice and data services, thus inducing intense price competition when mobile diffusion reached saturation.[164] The 3G-only MNO has typically adopted a similar entry strategy of positioning as the price leader by discounting basic voice and data mobile services through flat tariff plans. In particular, price competition would target those consumers with a high-medium propensity to spend, which are typically key for the early diffusion of a new generation of services.[165] In other words, the penetration pricing

accustomed to the uncertainties in the expected quality of the usage specific to content-based two-sided platforms. However, it is worth noting that this difference in usage profiles also affects the decision to purchase the mobile handset, whose enhanced functionalities would enable next-generation service. Therefore, differently from the game-console case, handset manufacturers would be faced with the same "chicken-and-egg" dilemma typical as software providers (instead of being cosponsor of the hardware platform), as the development and commercial launch of improved handsets would depend on the prospects for mass adoption. *See* Yanli Suo-Saunders, *supra* note 131, at 1.

[164] With reference to the UK market, see Mintel, *Mobile Phone and Network Providers* 24 (Market Intelligence, Oct. 2007), *available at* http://reports.mintel.com/.

[165] Michal Grajek & Tobias Kretschmer, *Usage and Diffusion of Cellular Telephony, 1998-2004* (NET Institute Working Paper No. 06-21, 2007), *available at* http://ssrn.com/abstract=931389, found that consumer heterogeneity in usage intensity was the main mechanism by which 2G had been adopted. For an illustrative case study, see Philip Kendall & Sara Harris, *Cellular Tariff Development in the UK* (Strategy Analytics, 2006), *available at* http://www.strategyanalytics.net/. From a forward looking perspective, see Philip Kendall, *Yoigo's Spanish Launch Hurt by MVNO Wave* (Strategy Analytics Insights, Dec. 2006), *available at* www.strategyanalytics.net ("Adding to

strategy typically adopted by "no-frills" MVNOs would forestall the similar penetration effort from the 3G-only operator,[166] which in turn would hamper the diffusion of the 3G platform in general,[167] given

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Yoigo's entrance, . . . [t]here are a number of players lining up to enter the market. . . . [O]ne of the players at most risk from this wave of MVNO activity will be Yoigo—as a new brand operating on a low-cost provider strategy, it will have to fight hard with the MVNOs for new business. From its launch on 1 December 2006 Yoigo has positioned itself as the first low-cost provider in the Spanish market. . . . While the incumbents will not need to respond immediately, Yoigo's broad reduction in prices cannot be ignored for too long.").

[166] Moreover, this negative impact would be amplified if the entry of no-frills MVNOs caused the repositioning of some or all incumbent GSM MNOs. This would be particularly the case when the minor GSM incumbent was directly threatened by no-frills MVNOs' entry pattern, thus prompting the latter the start a price war to oppose the new entrants. With regard to the UK mobile market, T-Mobile's repositioning between 2005 and 2006 was a case in point. *See* Kendall & Harris, *supra* note 165, at 15. The difficulty of sponsoring the new standard at the beginning of the diffusion process would be compounded by the fact that backward compatibility of the old standard would further restrain price setting even after the new standard became the dominant one, thus inhibiting the sponsor of the new standard from confidently feeding future efficiency gains (i.e., in terms of quality of services or larger scale economies) into initial penetration pricing. This (defiant) incumbency advantage is the key feature in certain industrial organization models of "naked exclusion," whereby in industries where demand-side or supply-side scale economies matter, if an incumbent firm deprives the more efficient entrant of vital buyers, the latter will not be able to operate profitably. *See* Chiara Fumagalli & Massimo Motta, *Buyers' Miscoordination, Entry, and Downstream Competition*, 118 ECON. J. 1196 (2008); and Liliane Karlinger & Massimo Motta, *Exclusionary Prices and Rebates When Scale Matters* (CEPR Discussion Paper No. DP6258), *available at* http://ssrn.com/abstract=1135496.

[167] The circumstance that there are multiple sponsors of the new standard could lead to an additional supply-side source of coordination failure, the so-called "splintering effect," whereby adopters not only face the decision whether to adopt or not, but also which standard to adopt (if any). Although splintering has so far been discussed only in contexts with incompatible standards, the same would apply when demand-side network effects are (partly) proprietary to different networks, even though technically compatible. This is the case when network effects are (mainly) indirect and firms have business-stealing incentives in promoting their own new platform. *See* Farrell & Klemperer, *supra* note 150, at 2022, and Tobias Kretschmer, *Splintering and Inertia in*

that GSM incumbents would have relatively lower incentives to promote the mass adoption of 3G.[168]

Network Industries, 56 J. INDUS. ECON. 685 (2008). Although it is beyond the scope of this article, it is worth noting that the proprietary nature of network effects over the 3G platform is at the core of the U.S.-centered debate on "wireless net-neutrality." The debate originated with a recommendation to subject the U.S. mobile wireless industry to "open" access regulation for attachment of devices to the network and also for suppliers of software applications. *See* Tim Wu, *Wireless Carterfone*, 1 INT'L J. COMM. 389 (2007). For an opposite view, see Robert W. Hahn, Robert E. Litan & Hal J. Singer, *The Economics of "Wireless Net Neutrality,"* 3 J. COMPETITION L. & ECON. 399 (2007).

[168] It is worth noting that the presence of an asymmetry in regulated mobile call termination (MCT) charges in favor of the 3G-only operator might have partly disincentivized 2G/3G MNOs from following the former MNO in pursuing 3G penetration through volume discounts, as this would have resulted in even larger interconnection deficits versus the former MNO. In this respect, the European Commission is leading on eliminating residual asymmetries in MCT regulated rates across European Member States, having recently launched a public consultation on termination rates. S*ee* European Commission, *Draft Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU* 17 (2008), *available at* http://ec.europa.eu/information_society/policy /ecomm/doc/library/public_consult/termination_rates/explanatory.pdf:

> A further (albeit related) argument cited in support of temporary asymmetry is the existence of traffic imbalances between larger incumbent operators and smaller new entrants. Where a new market entrant initially has lower traffic volumes than the more established incumbents, this can result in net payments to the incumbents which are typically net receivers of traffic. It is further argued that the financial disadvantages which new entrants face as a result of their lower traffic volumes can be exacerbated by differential on-net/off-net pricing policies pursued by the incumbent operators.
>
> It is difficult to see how arguments regarding financial imbalances resulting from differences in traffic volumes and differential on-net/off-net pricing would justify setting asymmetric termination rates. This is because asymmetric wholesale pricing is likely to reinforce the asymmetric pricing observed at retail level. That is, the off-net retail prices of the incumbents will likely rise to compensate for the increased cost of off-net wholesale termination to the new entrants. As long as traffic imbalances persist, asymmetric pricing will likely only contribute to perpetuating any resulting financial imbalances.

Not surprisingly, "[t]he penetration is highest in Luxembourg and Ireland with around 29% and 28% of subscribers respectively, followed by Italy and Portugal with around 25%. 16% of the total number of subscriptions in the EU are now 3G."[169] Those are countries with a historical marginal (if any) presence of MVNOs.[170] The same could be said of Sweden,[171] Spain and Greece,[172] which are all closely following the front runners in terms of penetration of 3G.[173] On the other end of the spectrum, it is again not surprising to discover that Belgium,[174] Denmark,[175] Germany, and the Netherlands all have low 3G penetration levels while having been historically characterized by a strong incidence of MVNOs.[176] Regarding the UK, "[t]he take-up of 3G progressed to reach 8.3 million users, or 11.6% of all mobile sub-

[169] European Commission, 13th Implementation Report—Volume 1, 19/03/2008 SEC(2008) 356, at 14, *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/library/annualreports/13th/SEC(2008)356DTS Vol1final.pdf.

[170] *See* GSMA, *European Mobile Industry Observatory 2008*, at 32, figures 30 & 31, *available at* http://www.gsmworld.com/documents/eur_ob.pdf.

[171] European Commission, *supra* note 169, at 305 ("While there are four mobile network operators providing GSM services, four mobile network operators providing UMTS (3G) services and one operator using CSDMA-450, the market share of mobile service providers (virtual network providers and resellers) remains low.").

[172] *Id.* at 141 ("As a result of a recent merger, there are currently three mobile operators on the Greek market with market shares of 38.11%, 34.88% and 27.01% respectively. The number of subscribers reached 11,814,529 in October 2007. Mobile penetration continued to rise, from 100% in October 2006 to 105.76% in October 2007. All mobile operators have 3G licences and are expanding their services using [high speed downlink packet access].").

[173] *See* GSMA, *supra* note 170, at 13, figure 5.

[174] European Commission, *supra* note 169, at 79 ("The coverage of each of the 3G networks was estimated to exceed 40% of the population according to IBPT/BIPT, i.e. the minimum provided by law.").

[175] *Id.* at 104 ("So far, 3G has not had a big impact, with approximately 500,000 customers (8%) divided between the incumbent, the two alternative operators and their subsidiaries. An additional operator launched its services in December 2007.").

[176] *See* GSMA, *supra* notes 170 & 173.

scribers (i.e. below the EU average), in October 2007. . . . The United Kingdom also has a relatively large number of mobile virtual network operators . . . and other service providers active on the mobile market, which provide services to a growing number of customers."[177]

Although far from being a full-fledged econometric analysis,[178] these facts are strongly indicative of a potential negative causal link between the penetration of the 3G platform and MVNOs' market presence among European Member States.[179] This transitional friction might result in a inefficient distortion where the welfare losses from dynamic efficiency forgone dominate the welfare gains from increased allocative efficiency that result from the presence of MVNOs in the market (i.e., lower prevailing prices). However, this calculation would be quite complicated in light of the greater ease of measuring the short run benefits from improved allocative efficiency, rather than the long run uncertain benefits from dynamic efficiency.[180] Moreover, the cir-

[177] European Commission, *supra* note 169, at 315.

[178] It is fair to say that the availability in the public domain of data (let alone time series) regarding certain features of the European mobile industry (e.g., country/company MVNOs' market shares and 3G penetration rates) is scarce, in particular, in comparison to the fixed/broadband industry.

[179] In this respect, the intergenerational nature of this transition process would point the link of causation away from the old standard, where no-frills MVNOs have typically been active, to the new standard, with MNOs having difficulty promoting adoption of the 3G platform.

[180] *See* Hausman & Sidak, *supra* note 86, at 404 ("One could estimate consumer welfare from the introduction of mobile telephony. Consumer welfare is approximately proportional to revenue divided by a function of the market price elasticity."). For an empirical estimation of the costs due to inappropriate regulation that delayed the introduction of 2G mobile services in United States, see Jerry A. Hausman, *Valuing the Effect of Regulation on New Services in Telecommunications* 13 (1 Brookings Papers on Econ. Activity: Microeconomics, 1997). However, in this specific case, the task would be complicated by the fact that the 3G (and beyond) technology would enable a two-sided platform potentially thriving on uncertain indirect network effects. *See* Shin-Won Kang, Sang-Sup Cho & Han-Young Lie, *The Economic Value of Next-Generation Converged Communications and Broadcasting Services*, 27 ELECS. & TELECOMM. RES. J. 759 (2005). Also, the intergenerational nature of this dynamic distortion would be difficult to address through traditional access pricing methodologies, as it would entail charging a mark-up on access prices over the old-generation platform to internalize the described intertemporal, mainly indirect, network externalities over the new-generation platform.

cumstance that both the 3G-only MNO and the discount MVNO adopt in part the same penetration strategy would suggest that the counterfactual did not necessarily imply a permanent trade-off between static and dynamic efficiency. As long as the 3G-only MNO fulfilled its penetration, incumbent 2G/3G MNOs would eventually follow suit by adopting the same penetration strategy. Therefore, the same achievement of dynamic efficiency would eventually exert downward pricing pressure on prevailing prices for basic voice and data services.[181]

Arguably, incumbents' reaction could be slower than that of discount MVNOs for at least two reasons: (1) while there is usually a sole 3G-only MNO for the long run, no-frills MVNOs would enter typically in multitude, being attracted by temporary conditions of profitability; and (2) while "no-frills" MVNOs would normally cannibalize MNOs' retail revenue sources, by commoditizing basic voice and data traffic, the 3G-only MNO's penetration is partly beneficial to MNO incumbents, as, by being characteristically the first mover to venture into an uncertain market,[182] it contributes to solve common demand uncertainty about 3G.[183]

[181] *See* Kendall, *supra* note 166 ("From its launch on 1 December 2006 Yoigo has positioned itself as the first low-cost provider in the Spanish market. Its flatrate EUR0.12/minute call charges across prepaid and postpaid services compares very favorably with market averages. . . . This level of discounts is something which has served Hutchison 3G well as it has looked to build market share across Europe since 2003. While the incumbents will not need to respond immediately, Yoigo's broad reduction in prices cannot be ignored for too long.").

[182] *See The Lex Column*, FIN. TIMES, Aug. 11, 2006 ("As operating trends continue their odyssey towards the abyss, most incumbents, and Vodafone, still adhere to the default strategy of maintaining short-term cash flow, the metric on which most sector valuations are based. This approach had its virtues when the bubble was collapsing but, five years on, imposes a strategic straitjacket. Miserably low multiples suggest companies should not prioritize the preservation of cash flow that the market already thinks is near worthless. *Instead they should experiment by lowering prices, subsidising new services.*") (emphasis added).

[183] For a general treatment on the interplay between first mover advantage and second mover advantage, relative to the value of information free riding, see Kuno K.J. Huisman, Peter M. Kort, Grzegorz Pawlina & Jacco Thijssen, *Strategic Investment Under Uncertainty: Merging Real Options with Game Theory* (CentER Discussion Paper No. 06, 2003), *available at* http://ssrn.com/abstract=545543; and Helen Weeds, *Applying Options Games: When Should Real Options Valuation be Used?* (University of Essex, 2006), *available at* http://privatewww.essex.ac.uk/~hfweeds/Applying%20options%20games.pdf.

V. CONCLUSIONS

The described risk of inappropriate intervention causing type I errors in the form of dynamic distortions due to the irreversibility of directly or indirectly mandating upstream access has policy implications with regard to antitrust and regulatory enforcement against an allegation of collective dominance in the form of refusal to start supplying wholesale access. First of all, regarding the establishment of the existence of a position of collective dominance, the assessment should focus on whether there are the incentives to arrive at tacit collusion in the first place, rather than stick to it, in order to avoid erroneously inferring the existence of a tacit collusive scheme from the absence of wholesale transactions in the presence of pent-up demand, which could instead be the result of rational unilateral decisions. On a subsidiary basis, the investigation should focus on the competitive restraints posed by actual or potential competitors outside the alleged collusive agreement, thus concentrating on the third criterion of the *Airtours* test, while being aware of the risk of circularity entailed when relying on the second criterion.

With reference to the conduct element of the alleged abuse, it would be restrictive to rule out as a legitimate efficiency defense[184] for a refusal to (start) supply(ing) the need to promote a new standard, whose diffusion process could otherwise be forestalled because of strategic competitive pricing from (would-be) operators active on the old standard, thus leading to "excessive inertia."

However, this would not be entirely satisfactory on at least two grounds. First, as the burden of proof for such an efficiency defense would be on the defendant,[185] the above-mentioned uncertainties in

[184] *See* Discussion Paper, *supra* note 9, at ¶ 84 ("For this defence the dominant company must demonstrate that the following conditions are fulfilled: i) that efficiencies are realised or likely to be realised as a result of the conduct concerned; ii) that the conduct concerned is indispensable to realise these efficiencies; iii) that the efficiencies benefit consumers; iv) that competition in respect of a substantial part of the products concerned is not eliminated."). However, while this is the general test for exclusionary conduct, the fourth criterion is unwarranted in a case of refusal to supply, whereby the exclusion of downstream competitors is a condition for an initial finding of abuse in the first instance.

[185] *Id.* at ¶ 87.

evaluating future efficiency gains would make it extremely difficult for the defendant to overcome an initial finding of abuse.[186] Second, while this allocation of the burden of proof is posited on an initial finding of abuse, the analysis presented in the previous part demonstrates how the assessment of whether the alleged colluding firms actually had unilateral incentives to start supplying wholesale access could be overlooked.[187] This could be particularly so, given that the need to promote a new generation of services could partly justify the unilateral refusal from the alleged colluding firms in the first place. In other words, while for a finding of abuse of a position of collective dominance it is necessary that firms find it unilaterally rational to supply wholesale access, the opposite holds generally true for a case of unlawful refusal to supply from a position of single dominance.

These considerations would suggest reversing the burden of proof by introducing as a requirement for raising a duty to deal under a position of collective dominance that the undertaking that requests wholesale access not intend to limit itself essentially to duplicating the goods or services already offered on this market by the individual owners of the physical essential facilities, but intends to produce new goods or services not already offered and for which there is a poten-

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[186] *Id.* at ¶ 89 ("In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. In general, the later the efficiencies are expected to materialise in the future, the less weight the Commission can assign to them. This implies that, in order to be considered as a counteracting factor, the efficiencies must be timely.").

[187] It is worth noting how the first three criteria of the general efficiency defense test proposed in the Discussion Paper closely resemble the "market-expanding" efficiency defense test for an allegation of predatory pricing proposed in Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 89 GEO. L.J. 2495 (2001). In particular, three concurrent criteria of justification were presented: 1) plausible efficiency gains; 2) no less-restrictive alternative; and 3) efficiency-enhancing recoupment (rather than recoupment from increased profit through eliminating or disciplining rivals). However, under the circumstances described in the previous part, the "profit sacrifice" test encompassed in the assessment of whether refusal to start supplying was unilaterally rational would be far less straightforward than in a case of predatory pricing, where the failure to cover a defined cost benchmark would provide a strong indication of intention to foreclose.

tial consumer demand. In particular, the new product or service should "*expand[]* the market by bringing in consumers who were not satisfied before."[188]

These recommendations should be valid under both antitrust and regulatory enforcement, as a position of collective dominance would be generally posited on an oligopolistic (rather than ex-monopolistic) market structure, which should thus not demand a special and more interventionist treatment under the regulatory regime. In this respect, as part of the three criteria test to determine whether a market is a candidate market for ex ante regulation, the ECNS Regulatory Framework requires NRAs to establish the insufficiency of competition law alone to adequately address the market failure(s) concerned.[189] However, there is a risk for regulatory intervention to be overinclusive when justified on the ground that the insufficiency of competition law was due to the higher burden of proof required to trigger intervention.[190] This would be particularly so for markets no longer listed as being susceptible of ex ante regulation, for which a presumption of insufficiency of competition law may be justified "where the market situation may still be closer to the one identified in the first round of market analysis."[191] Such an enforcement approach could be perplex-

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188 *See* PADILLA & O'DONOGHUE, *supra* note 22, at 447. As noted in the previous part, this "market-expanding" feature would be essential in making the decision to start supplying upstream access unilaterally rational.

189 Commission Recommendation, *supra* note 47, art. 2(c).

190 See European Regulators Group, *Guidance on the Application of the Three Criteria Test* 14 (ERG (08) 21, 2008) ("[I]n cases of vertical integration where one of the potential market failures identified is the leveraging of market power towards downstream markets, regulatory obligations could be needed. In these instances, it is important to recall that access mandated under competition law provisions would be subject to very strict requirements, which may find no application in the cases at stake. . . . As mentioned above, it is also important to recall that mandatory access is more difficult to impose under competition law. Likewise, competition law may in certain instances be insufficient to address problems arising in markets that exhibit collusive (collective dominance) features.").

191 *Id.* at 17 ("Also, in order to prove fulfilment of the three criteria test for maintaining regulation in a market listed in the 2003 Recommendation but not in the 2007 Recommendation, in principle it should be sufficient for

ing given that "the second criterion assesses whether a market would tend towards effective competition without regulation."[192]

NRAs to substantiate why the elements invoked by the European Commission in its Explanatory Note to justify withdrawal of a market from the list on the basis of the three criteria are not applicable to the national circumstances, thus leading to the conclusion that the situation is closer to that existing under the 2003 Recommendation.").

[192] *Id.* at 12.