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Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development 23-May-2007

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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WP3/WD(2007)41
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Working Party No. 3 on Co-operation and Enforcement

HOW TO PROVIDE EFFECTIVE GUIDANCE TO BUSINESS ON MONOPOLISATION/ABUSE OF DOMINANCE

-- The United States --

5 June 2007

The attached document is submitted by The United States to Working party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 5 June 2007.

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JT03227672

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1. Policy Guidance on Single-Firm Exclusionary Conduct

1. Single-firm conduct in the United States is governed by section 2 of the Sherman Act, which prohibits the acquisition or maintenance of monopoly power through the use of exclusionary conduct.[1] Providing useful guidance to business on the application of Section 2 presents a challenge "because 'the means of illicit exclusion, like the means of legitimate competition, are myriad.'"[2]

2. Over more than a century of Section 2 enforcement, guidance has come from several sources. Most importantly, case law from enforcement actions has provided legal certainty on important points. The enforcement agencies in the United States aid in the process of case law development through their enforcement actions and through friend of the court briefs in private cases. The agencies also use speeches and reports to clarify the law and to inform the business community of the agencies' enforcement policies. The agencies have not issued guidelines on the application of Section 2.

3. General principles for the application of Section 2 have the flexibility to adapt to the particular facts of each case. More precise rules, whether formulated in agency guidelines or by courts, can greatly reduce administrative costs and enhance business certainty. The latter effect clearly furthers the goals of competition policy to the extent that uncertainty chills procompetitive conduct. Of course, more precise rules also may explicitly prohibit some procompetitive conduct as well as explicitly permit some anticompetitive conduct. Striking the right balance presents a constant challenge.[3]

2. Courts in the United States and the Development of Safe Harbors

4. Section 2 of the Sherman Act was written in very general language, to which the courts have given specific meaning through decisions in individual cases. Case law has made clear that the vast majority of competitors in the United States would not be found to possess monopoly power.[4] Courts in the United States have consistently held that a market share below 50% cannot support the inference of monopoly power,[5] and the leading treatise suggests that a share of at least 70–75% for five years is required to infer monopoly power.[6] Modern case law also holds that "market share is only a starting point for determining whether monopoly power exists, and the inference of monopoly power does not automatically follow from the possession of a commanding market share."[7] Courts in the United States require proof that entry would not effectively discipline a competitor alleged to possess monopoly power,

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[1] *See* Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

[2] *Id.* at 414, quoting United States v. Microsoft Corp., 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (per curiam).

[3] *See, e.g.*, William Blumenthal, *Clear Agency Guidelines: Lessons from 1982*, 68 ANTITRUST LAW JOURNAL 5 (2000).

[4] Monopoly power has been defined as "the ability (1) to price substantially above the competitive level *and* (2) to persist in doing so for a significant period without erosion by new entry or expansion." AD/SAT v. Associated Press, 181 F.3d 216, 227 (2d Cir. 1999).

[5] *See, e.g.*, Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic, 65 F.3d 1406, 1411 (7th Cir. 1995) ("Fifty percent is below any accepted benchmark for inferring monopoly power from market share . . . .").

[6] 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 801a, at 319 (2d ed. 2002).

[7] American Council of Certified Podiatric Physicians & Surgeons v. American Board of Podiatric Surgery, Inc., 185 F.3d 606, 623 (6th Cir. 1999).

and firms with market shares well in excess of 50% have been found not to possess monopoly power because their power over price was insufficiently durable.[8]

5. Case law in the United States also has given even competitors with monopoly power substantial latitude in pricing aggressively. A successful challenge to price cutting under section 2 of the Sherman Act requires proof "that the prices complained of are below an appropriate measure of the rival's costs" and that the alleged predator had "a dangerous probability . . . of recouping its investment in below-cost prices."[9] The courts have not fully specified the details of applying these principles but have established two critical principles: the test is demanding, and the relevant measure of cost is not average total cost, but rather marginal, average variable, or incremental cost.[10]

6. More generally, the case law has long held that Section 2 prohibits "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[11] By explaining Section 2 in this way, "the courts have sought to draw a distinction between merits- and non-merits-based competition that excludes."[12] The courts have consistently held that harm to a competitor is far from sufficient to make conduct anticompetitive.[13] Indeed, a "monopolist, no less than any other competitor, is permitted and indeed encouraged to compete aggressively on the merits."[14] Moreover, courts have only rarely found that violations of Section 2 had been committed. The case law, however, has not yet fully defined the specific categories of conduct that constitute lawful competition on the merits.

3. Enforcement Actions, Friend of the Court Briefs, Hearings, and Reports

7. Agencies in the United States often seek to clarify the law through their enforcement actions. The Federal Trade Commission (FTC) is empowered to conduct administrative hearings and issue orders, which affords the opportunity to clarify the law in decisions rendered by the agency. In 2006 the FTC issued a decision explaining why it determined that the conduct of Rambus, in conjunction with standard-setting activities, was unlawfully exclusionary.[15] The U.S. Department of Justice (Department) has no

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8 *E.g.*, Western Parcel Express v. United Parcel Service of America, Inc., 190 F.3d 974, 975 (9th Cir. 1999); Tops Markets, Inc. v. Quality Markets, Inc., 142 F.3d 90, 99 (2d Cir. 1998); Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of America, 885 F.2d 683, 695–96 (10th Cir. 1989).

9 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222, 224 (1993).

10 *See, e.g.*, United States v. AMR Corp., 335 F.3d 1109, 1115–16 (10th Cir. 2003); Stearns Airport Equipment Co. v. FMC Corp., 170 F.3d 518, 532 (5th Cir. 1999); Advo, Inc. v. Philadelphia Newspapers, Inc., 51 F.3d 1191, 1198 (3d Cir. 1995).

11 United States v. Grinnell Corp., 384 U.S. 563, 570–71 (1966). The Supreme Court cited this statement as controlling authority in Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

12 Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST LAW JOURNAL 3, 14 (2004).

13 *See, e.g.*, Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 458 (1993) ("The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself."); Town of Concord v. Boston Edison Co., 915 F.2d 17, 21 (1st Cir. 1990) ("a practice is not 'anticompetitive' simply because it harms competitors. After all, almost all business activity, desirable and undesirable alike, seeks to advance a firm's fortunes at the expense of its competitors. Rather, a practice is 'anticompetitive' only if it harms the competitive process.").

14 Olympia Equipment Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 375 (7th Cir. 1986).

15 The FTC's decision and extensive additional materials are available at http://www.ftc.gov/os/adjpro/d9302/index.htm.

administrative powers, but rather enforces the Sherman Act in court. In recent years, the Department has explained, especially in its appellate briefs, why it believed that several forms of exclusionary conduct by American Airlines, Dentsply, and Microsoft were unlawfully exclusionary.[16] Both agencies also use speeches by agency officials to clarify both enforcement policies in general and actions in specific cases.[17]

8. When a competition law case not involving the government as a party comes before the Supreme Court of the United States, the enforcement agencies typically file a friend of the court brief articulating legal principles that can clarify the law.[18] In *Trinko*,[19] the agencies argued that, when "the plaintiff asserts that the defendant was under a duty *to assist a rival*, . . . conduct is not exclusionary or predatory unless it would make no economic sense for the defendant but for the tendency to eliminate or lessen competition." Most recently, in *Weyerhaeuser*,[20] the agencies successfully argued that the price-cost test applied to predatory pricing by a seller also should be applied to predatory pricing by a buyer.

9. On April 17 of this year the enforcement agencies in the United States released a report on the relationship between antitrust law and intellectual property law.[21] Among other things, the report addresses unilateral refusals to license. The report concludes that:

> Antitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections. Antitrust liability for refusals to license competitors would compel firms to reach out and affirmatively assist their rivals, a result that is "in some tension with the underlying purpose of antitrust law." Moreover, liability would restrict the patent holder's ability to exercise a core part of the patent—the right to exclude.[22]

10. Over the past year, the enforcement agencies in the United States have conducted extensive public hearings on single-firm exclusionary conduct.[23] The primary goals of the hearings were to examine the competitive implications of all forms of potentially exclusionary conduct by individual competitors and to determine the appropriate treatment of such conduct under section 2 of the Sherman Act. In the hearings, the agencies heard the views of many academics, practitioners, and business persons. Because the agencies sought diverse points of view, participants in the hearings may not have been unanimous on any issue, but several important principles resonated throughout the hearings.

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16 These briefs are available at http://www.usdoj.gov/atr/public/appellate/appellate.htm.

17 Speeches by officials of the agencies can be found at http://www.usdoj.gov/atr/public/speeches/speeches.htm and http://ftc.gov/speeches/speech1.shtm.

18 These briefs and others are available at http://www.usdoj.gov/atr/public/appellate/appellate.htm. The agencies also filed friend of the court briefs in the lower courts.

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

20 Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007).

21 U.S. Department of Justice & Federal Trade Commission, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition, *available at* www.usdoj.gov/atr/public/hearings/ip/222655.pdf; http://ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf. The report was preceded by public hearings in which the agencies heard the views of more than 300 persons. The bulk of the report concerns issues arising in the licensing context and hence issues outside the scope of Section 2.

22 *Id.* at 6 (footnote and internal quotation omitted).

23 Extensive materials relating to the hearings are available at http://www.usdoj.gov/atr/public/hearings/single_firm/sfchearing.htm; http://ftc.gov/os/sectiontwohearings/index.shtm

11. Single-firm conduct that undermines the competitive process to a degree that it creates or maintains monopoly power should be the subject of an enforcement action. Yet even competitors with monopoly power should be permitted to compete aggressively, and neither their success, nor injury to smaller rivals, by itself, demonstrates harm to the competitive process. Because it may be difficult to distinguish between lawful, aggressive conduct and exclusionary conduct,[24] businesses would find it helpful to have clear and objective rules that allow them to assess their practices and avoid chilling procompetitive conduct. It is also important that remedies be closely tailored to address the harm to the competitive process in each case and that remedies not distort the competitive process or discourage innovation.

4. Agency Experience with Competition Policy Guidelines

12. Enforcement agencies in the United States have not issued guidelines on single-firm exclusionary conduct, but they nevertheless have considerable experience with guidelines.[25] This experience has taught that competition policy guidelines are unlikely to substantially assist the business community if they merely set out factors considered in the agency's analysis and do not indicate when and why certain combinations of factors are apt to lead to an enforcement action.[26]

13. Guidelines on single-firm exclusionary conduct could usefully enhance legal certainty by creating safe harbors. The rationale for most such safe harbors would not be that certain competitors or particular conduct pose no risk of harm to competition, but rather that certain competitors or particular conduct pose insufficient risk of harm to warrant further consideration in view of the administrative costs of proceeding, the potential social harm from erroneous condemnations of conduct, and the chilling effect on legitimate conduct of business uncertainty.

14. In particular, guidelines could set out a market share below which a competitor is conclusively presumed not to possess monopoly power (or not to be dominant). A safe harbor significantly enhances legal certainty only if the market-share threshold adopted is high enough that it affords safety to competitors that had perceived a non-trivial risk of being found to possess monopoly power. Indeed, adopting a safe-harbor market share that is very low actually could increase business uncertainty by suggesting an increased likelihood that competitors just outside the safe harbor will be found to possess monopoly power. On the other hand, adopting a safe-harbor market share threshold that is too high creates substantial legal certainty at an unacceptably high cost in terms of consumer harm from exclusionary conduct by competitors that possess monopoly power but nevertheless fall within the safe harbor.

15. Guidelines on single-firm exclusionary conduct also could enhance legal certainty significantly by creating safe harbors in the form of categories of conduct considered lawful competition on the merits. For example, guidelines could state that a competitor, even a monopolist, engages in lawful competition on

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[24] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993) (It is often "difficult to distinguish robust competition from conduct with long-term anticompetitive effects.").

[25] In 1992 the agencies jointly issued guidelines on horizontal mergers (revised in 1997); in 1994 they issued policy statements relating to health care (revised in 1996); in 1995 they issued guidelines on licensing intellectual property and guidelines on international operations; and in 2000 they issued guidelines on collaborations among competitors. In addition, the U.S. Department of Justice issued merger guidelines in 1968, 1982, and 1984; international operations guides or guidelines in 1972, 1977, and 1988; guidelines on vertical restraints in 1985 (withdrawn in 1993); and a guide on research joint ventures in 1980.

[26] This experience also has taught that competition policy guidelines are most useful when they provide new insight on the substantive analysis or establish bright lines demarcating either lawful or unlawful conduct. In addition, this experience has taught that crafting useful competition policy guidelines is quite difficult, but the attempt itself can be a valuable learning experience.

the merits when it prices aggressively but does not price below cost, when it makes investments that simply reduce its own costs, and when it introduces a new product. Stating such principles in a general manner could be useful, but greater business certainty would result from guidelines that defined these categories with sufficient clarity and detail that businesses normally would know with confidence whether they are in the safe harbors. For example, a guideline on predatory pricing could not only state that pricing above cost is lawful but also specify the appropriate measure of cost, the relevant units of output for which cost is measured, and the proper measure of associated revenues. Of course, crafting such detailed guidelines would require careful reflection and sensitive drafting. It is difficult to anticipate and address every scenario that may be presented by future cases.

16. Guidelines on single-firm exclusionary conduct might enhance legal certainty by articulating, for particular categories of conduct, either conditions necessary for the conduct to produce the sort of effect required to violate the law or conditions necessary for an agency even to investigate whether such an effect is likely. Finally, guidelines can mitigate uncertainty by declaring an agency's enforcement intentions, priorities, or presumptions.

17. Each competition agency must decide for itself which, if any, of the foregoing means of enhancing legal certainty would both promote the goals of competition policy and be useful to the business community. Each competition agency also must decide whether formal guidelines serve the interests of the agency and business community better than speeches or other less formal policy statements. Thus far, the enforcement agencies in the United States have employed other means for developing the law and stating their enforcement policies.