Antitrust and Competition Policy: A Primer
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Introduction

Routine business decisions involving prices, terms and conditions of sale, supplier and customer contacts, advertising, acquisitions, divestitures and numerous other activities have implications under federal antitrust laws. These laws are intricate, and even unintentional violations can result in significant penalties. Thus, an understanding of the scope and contours of the antitrust laws is necessary to guard against possible violations.

This overview of antitrust law corresponds to the antitrust implications of topics discussed in class. It covers the five topics that are most relevant to the activities and decisions of business leaders: vertical restraints, business combinations, price discrimination, collusion and cartels, and predation and other exclusionary practices. The overview then discusses additional complexities presented by intellectual property and international antitrust law, and concludes with general guidelines designed to reduce antitrust complications from business activity. Links to additional reading and questions for review and discussion are provided in some sections.
Vertical Restraints

When organizing product distribution, sellers often resort to a variety of restrictions aimed at the orderly marketing of their goods. These “vertical restraints” may range from agreements between suppliers and buyers concerning the price at which a buyer may resell (vertical price-fixing) to exclusive dealing agreements and territorial restrictions (non-price vertical restraints) to boycotts of certain buyers (refusals to deal).

As with many other business aspects, vertical restraints fall under the scope of antitrust laws. In reviewing vertical restraints, the United States Justice Department (DOJ) and the Federal Trade Commission (FTC) rely on section one of the Sherman Act, enacted in 1890, which prohibits contracts, combinations, or conspiracies between companies that unreasonably restrain trade or commerce. Section three of the Clayton Act, enacted in 1914, which prohibits certain agreements that would substantially reduce competition, sometimes applies as well.

Vertical Price-Fixing

Vertical price-fixing agreements, in which a seller and buyer agree on the price at which the buyer will resell, have typically been considered per se illegal. The reasonableness or wisdom of the agreed-upon price is irrelevant. The only exception to this general rule is that of fixing a maximum price: in reviewing the State Oil vs Kahn case in 1997, the Supreme Court decided that such restraint is not per se illegal and should instead be judged on a case by case basis (rule of reason).

To fall within the per se prohibition, an agreement between the buyer and the seller that the buyer will resell at a specified price or price level must exist. Unlike horizontal agreements (discussed under Collusion and Cartels), the per se prohibition does not apply to vertical agreements that merely affect prices.

For liability purposes, the crucial question is whether an agreement exists. The courts have indicated clearly that a seller may properly suggest a resale price to its vendee. The vendee’s use of the suggested price is not sufficient to demonstrate that a conspiracy exists. Thus, manufacturers or other suppliers would be well-advised to use the word "suggested" when mentioning resale prices to clarify their intent.

Consignment Sales

For many years it was accepted antitrust doctrine that, in consignments to a true agent (as opposed to an agency relationship created by a mere formal arrangement), a seller was free to set the price at which "its" products were sold, even though the agent was otherwise independent in other respects. The United States Supreme Court has seriously questioned the continuing validity of this freedom. Vertical price fixing under the guise of consignment is apparently dangerous whenever the seller is able, by using economic
leverage, to "coerce" compliance by the consignees. The prudent course is to use consignment selling only if there is a good nonprice reason for doing so and, whenever such a method is employed, to treat the consignee as a true agent—the seller should pay taxes and insurance, maintain inventory control, and approve significant decisions.

**Non-price Vertical Restraints**

Provided marketing arrangements do not involve unlawful vertical price fixing, they are governed by the “rule of reason,” which condemns such arrangements only when they are deemed unreasonable in the totality of the market’s economic circumstances.

**Exclusive selling agreements**

Sellers may grant an exclusive franchise to a particular dealer in a specified territory by agreeing to sell only to that dealer within its area of responsibility. Such restraints, which are limitations upon the seller's freedom, are governed by the rule of reason and are typically valid. Even if the seller is induced to grant such an "exclusive" franchise by the dealer, the courts have not found an illegal concert of action.

**Territorial and customer restrictions**

Orderly marketing plans have often used arrangements whereby dealers agree to resell the product only within specified territories and to solicit business only from specified classes of customers. These arrangements restrict the dealers’ freedoms with respect to the buyers. Such restraints are subject to the rule of reason—their validity depends on economic justification, so long as the agreements are purely vertical and do not involve horizontal conspiracy among the dealers. The issue is whether the anticompetitive effect of the restraint on intrabrand competition (among dealers selling the same brand) is outweighed by the procompetitive effect on interbrand competition (among different brands) generated by strengthening the competitive ability of the seller.

Because of the intense interbrand competition between Coca-Cola and Pepsi, their respective producers use territorial restrictions on their bottlers and resellers extensively. While the companies maintain that territorial restrictions further quality control, the territorial assignments also establish **price discrimination** in different markets.

While most vertical customer and territorial restrictions have been upheld, some restrictions have been invalidated. For example, the European Commission (EC) recently accused Nintendo of illegal territorial restrictions. Nintendo had partitioned the single European market into different areas and awarded these submarkets exclusively to different distributors. The EC intervened because Nintendo's policies created higher prices overall and significant price differences.
across countries. For more information on European antitrust policies, see International Aspects.

As the Nintendo case demonstrates, if the seller has a significant market share, the validity of territorial restrictions is sometimes questionable, and less restrictive methods of orderly marketing should be considered. These less restrictive methods include assignment to dealers of an area of primary responsibility in which it must exercise its best efforts to promote sales. A quota system can be used to implement such a device. With certain products for which service or installation is important, dealers can be required either to install and service all machines they sell or, if they prefer, to pay a fee to a local dealer for assuming that obligation. The amount of the fee should be reasonably related to the cost of the service.

**Exclusive dealing agreements**

Exclusive dealing agreements, pursuant to which the buyer undertakes to purchase all its requirements for the product from the seller, are governed by section three of the Clayton Act, which prohibits such contracts if they are likely to substantially lessen competition. The principal vice of exclusive dealing arrangements is that, if they tie up a significant portion of the market, the seller's competitors will lose market access and experience a competitive disadvantage.

The development of the law in this area has been marked by some dramatic changes. In 1949, the United States Supreme Court ruled that, if an exclusive dealing arrangement forecloses a substantial share of total sales in the market (measured by percentage), the arrangement was invalid; a finding of 6.7 percent foreclosure was deemed sufficient. Twelve years later, however, reliance on numbers alone was abandoned, and a test requiring a case-by-case evaluation of the exclusive's probable effect on competition was announced. Recent decisions have followed that lead and, in effect, have applied the rule of reason.

As with territorial and customer restrictions, the rule of reason does not invalidate all exclusive dealing agreements. Particularly for a seller with a significant market share, the prudent course is to avoid widespread use of exclusive dealing arrangements or any single agreement or group of agreements that would restrict a large number of outlets. Antitrust risk can be minimized by requiring dealers to purchase absolute minimum quantities, or through similar undertakings designed to ensure adequate inventories.

**Tying arrangements**

Sellers with more than one product may seek to tie the sale of one product, which the customer presumably desires, with that of another product, which it presumably does not desire. Such tie-ins are governed not only by the general language of the Sherman Act, but the more particular provisions of section three of the Clayton Act, which prohibits
such arrangements if the likely result is substantially reduced competition. Tie-ins are per se unlawful if the seller possesses sufficient market power in the desired product, and coerces the buyer to take the tied product as a condition to obtaining the desired product.

The central problem with respect to tie-ins is often definitional. Certainly, a shoe producer may require that a left shoe be purchased with a right shoe. The question boils down to whether the two products have separate demand functions, so that customers ordinarily will buy them separately.

The antitrust problem with tie-ins is that the leverage generated by economic power in one market is used to create sales in another. Once the presence of a tie-in is established, the tie-in is generally deemed unlawful if the seller has sufficient economic power in the desired product to force sales of the tie-in and if a "not insubstantial" amount of sales is involved (amounts as small as $60,800 have been found to meet this standard).

In some instances, tie-ins justified by exceptional competitive circumstances have been upheld. For example, they have been permitted in new industries and as part of a franchise operation involving the licensing of the seller's trademark to franchisees.

**Refusals to Deal**

Vertical boycott agreements have been harshly treated, although the courts in recent years have grown more lenient. As a general rule, a seller should not agree with some of its customers that it will not sell to another. If such an agreement can be shown, the refusal to deal is likely to be the subject of litigation and, if there is evidence of an agreement with the compliant customers as to the prices or price levels they charge, a rule of per se illegality can be applied.

On the other hand, a seller has traditionally been afforded the right, acting independently, to select those with whom it transacts business. For example, a seller may decline to deal with buyers who do not comply with certain suggestions (such as resale prices). But if such a seller agrees with others to enforce its policy, independent action is not present and an unlawful combination may be found. Therefore, when deciding to cut off a customer, dealers must avoid any inference of concerted action with others. If complaints are received from sellers about another seller, it is dangerous to inform the complaining parties of the eventual outcome because such a communication could support the conclusion that concerted action is present.
Business Combinations

One of the primary concerns of the antitrust authorities is regulating business combinations, in order to prevent the creation of monopolies through mergers and acquisitions. The Hart-Scott Rodino (HSR) Act, together with the Federal Trade Commission Act and the Clayton Act, give the FTC and the DOJ the opportunity to obtain preliminary relief against anticompetitive mergers and prevent interim harm to competition and consumers.

Economic Considerations

In attempting to determine whether a given merger will have an anticompetitive effect, the government will consider many factors. These factors include: the existing market power of competitors, the ease of entry into the relevant market, the countervailing bargaining power of purchasers, the potential for collusion among the merger entity and competitors, and any efficiencies obtained from the merger.

Market Power

The Clayton Act regulates business combinations that can create or strengthen market power or facilitate its exercise. “Market power” is defined as the power to reduce output and raise prices above marginal cost, and to make a profit by doing so.

Market concentration is used as a proxy for appraising the danger of market power resulting from a horizontal merger. Indeed, the Celler-Kefauver amendments to the Clayton Act stipulate that any merger that “produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in…concentration…is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.”

Thus, the starting point for merger analysis has traditionally been to define the relevant market and calculate the pre- and post-merger market concentration. Common methods for assessing market concentration are the Herfindahl-Hirschman Index (HHI) and the four-firm concentration ratio. A significant increase in concentration in an already concentrated market is presumed to reduce competition because the reduction in the number of competitors in a market facilitates coordination of pricing and other terms of sale among competitors.

As of late, however, the FTC and DOJ have looked beyond concentration statistics to focus upon the other factors described below.
Barriers to Entry

Perhaps the most important factor mitigating a merger’s perceived anticompetitive effect is the possibility of entry. If entry barriers are low, it is unlikely that market power will persist because high profits will prompt new firms to enter the market. In industries in which substantial barriers to entry do not exist, a firm can retain its market share only by competitive pricing and the merger will not raise antitrust concerns, even if the market is highly concentrated.

The FTC and DOJ employ a 3-step process to determine whether committed entry would deter or remedy a competitive effect of concern. The first step assesses whether entry can achieve a significant market impact within a timely period. The second step assesses whether committed entry would be profitable, and thus a likely response to a significant and permanent price increase. The third step assesses whether entry would be sufficient to return market prices to their premerger levels. The fact that entry has not occurred frequently in the industry in question, while probative to the ease of entry, is not always fatal. Rather, it may merely reflect the degree of competitiveness in the current market.

Power of Purchasers

The counterbalancing power of purchasers is a factor considered by some recent cases, including United States v. Archer-Daniels-Midland Co., 1991. The courts recognize the competitive significance of large and sophisticated buyers in the relevant markets, including markets with only a few sellers. The stronger and more concentrated the buyers, the less able sellers are to increase prices. Concentration on the buying side tends to inhibit collusion by sellers because it creates stronger incentives to cheat within the cartel. Also, sophisticated purchasers, who place large orders, use competitive bidding and other methods to pressure sellers not to raise prices.

Evidence of Price Collusion

Evidence concerning the difficulty of successful price collusion is an important factor when evaluating the likely competitive effects of a merger. The agencies and the courts worry that the acquisition of a competitor may enable the acquiring company to cooperate with other leading competitors on reducing or limiting output, resulting in increased market prices. Collusive behavior is most likely to occur in concentrated industries with homogenous products, and is less likely to occur in industries with heterogeneous products. When products are heterogeneous, the products compete with one another on the basis of their characteristics, as well as on the basis of price. Courts have considered premerger pricing patterns and profitability among the various competitors and industry wide as well as the existence of excess capacity when analyzing the potential anti-competitive effects of a merger.
Merger Review Process

In general, the HSR Act provides that certain proposed acquisitions of voting stock or assets must be reported to the FTC and the DOJ before consummation. The primary purpose of the statutory scheme is to provide the DOJ and FTC the opportunity to review mergers and acquisitions before they occur. Whether a transaction is subject to HSR reporting depends upon the value of the acquisition and the size of the parties’ assets and sales. Small acquisitions and other classes of acquisitions that are less likely to raise antitrust concerns are exempt from HSR reporting. Once a HSR report has been submitted to the FTC and DOJ, the parties must wait 30 days (15 days in the case of a cash tender offer or bankruptcy sale) or until notified by one of the agencies that early termination of the waiting period has been granted, before they may close the transaction. The waiting period provides the FTC and DOJ with the time and the information necessary to review the proposed transaction.

During the waiting period if either agency desires to conduct a further inquiry, it can (under the Clayton Act) request additional information or documentary materials from both sides of a reported transaction (a “second request”). A second request extends the waiting period for a specified period after all parties have complied with the request for additional information (or, in the case of a tender offer or a bankruptcy sale, after the acquiring person complies with the request). This additional time (typically 20 days) enables either the FTC or DOJ to analyze the additional information and either block the transaction with an injunction granted by a federal district court, allow the transaction to close with certain provisions (see AOL/Time Warner), or simply permit the transaction to close.

Horizontal Merger Guidelines

Review of a proposed horizontal merger (e.g. one between competitors) is typically conducted under the framework set forth in the Horizontal Merger Guidelines, jointly issued by the DOJ and the FTC in 1992. The analytical framework of the Guidelines involves the following:

1. defining the relevant product and geographic market and identifying firms that compete in these relevant markets;
2. measuring concentration in the relevant markets using the HHIs;
3. assessing the ease of entry by new firms into the markets;
4. assessing the likely competitive effects of the merger in light of the market concentration and other factors that characterize the markets; and
5. considering any significant efficiency resulting from the merger that could not be achieved by other means.

The recent creation of Daimler Chrysler is a classic horizontal merger <see http://www.stern.nyu.edu/~lcabra/ufm/examples/DaimlerChrysler.html>. Executives at the firm justified the merger based on an estimated $3 billion a year in cost savings from,
among other things, reducing back-office costs, eliminating overlapping research, and consolidating parts and equipment buying. The merger passed through the antitrust authorities with minimal complications.

Other recent horizontal mergers have been less fortunate. The FTC compelled Exxon and Mobil to divest 2,400 gas stations before they could consummate their merger and forced Arco and BP to divest assets on Alaska's North Slope before they could merge. Least fortunate of all was the Office Depot/Staples merger, which was blocked entirely. At the surface, the merger appeared unproblematic, because thousands of retailers sell office supplies. But FTC economists examining sales price and quantities at the two chains found strong evidence that Staples’s prices were lower in cities where it competed with Office Depot. The courts concluded that permitting the merger would allow Staples to raise prices, and blocked the merger.

**Vertical Merger Guidelines**

According to the DOJ, its policy is "to exercise caution in taking actions against vertical transactions to avoid chilling efficiency-enhancing mergers that pose little risk of harm to competition." Vertical mergers can harm competition "under fairly limited conditions," which are "controversial" and "harder to determine." Vertical mergers, however, can also yield "plausible efficiencies" in the form of "reduce[d] transaction costs," "improved coordination of design, production and distribution" and "more efficient pricing." Although the ability of other means (such as a long-term contract) to achieve such efficiencies is relevant, the DOJ's policy is to avoid "an ex post search for the ‘least restrictive alternative.’ "

The DOJ stated that it will "look closely" at a vertical merger "if [the] proposed transaction involves the unification of a dominant firm in a concentrated market with significant entry barriers with a significant producer of complementary products in a concentrated market with entry barriers." The ability of vertical mergers to create or strengthen entry barriers was said to be important in "certain networked industries — such as telecommunications, cable, and computers." Before the DOJ would find harm to competition arising from a vertical merger, however, "there must be a probable downstream . . . effect . . . [in the form of] higher prices or lower output." If the vertical merger "simply allows the integrated firm to capture a larger share of the downstream market without reducing total output, there is no output effect."

The DOJ identified three "theories" of anticompetitive effect: (1) foreclosure/raising rivals' costs, (2) increased potential for anticompetitive coordination from the sharing of price, technology and other important nonprice information between competitors as customers and suppliers, and (3) evasion of regulatory constraints on the exercise of the market power of a natural monopoly. However, the "lack of a highly articulated theory of [vertical merger anticompetitive] effects . . . means that vertical transactions will be examined on a much more case-specific basis without the benefit of concrete vertical merger guidelines with bright line thresholds."
Under the Clinton Administration, the FTC was far more aggressive in challenging vertical mergers than these guidelines would suggest. For example, the merger between Barnes & Noble (book retailer) and Ingram Book Group (book wholesaler) were subject to regulatory examination due to the agencies’ vertical concerns. The recent AOL-Time Warner merger was essentially a vertical merger with few apparent antitrust problems. "The companies thought it was going to be slam dunk," recalls Robert Litan, an ex-antitrust official in the Clinton administration. The reality was far different due to vigorous action by the FTC. Time Warner had previously been subject to the FTC’s vertical monopoly scrutiny when it purchased Turner Broadcasting; the media powerhouse was forced to promise that it would include news networks other than CNN on its cable systems.

Degree of Enforcement

In 2000, the DOJ challenged 47 transactions; 18 of these challenges were resolved by consent decrees; and 29 were restructured or abandoned after the DOJ sued or informed the parties that it intended to sue. The latter included the telecommunications services merger of Worldcom, Inc. and Sprint Corporation, which was litigated in federal district court and in which the DOJ prevailed.

Despite the increased merger activity in 2000 (the number of merger investigations was at a record high), both the percentage and the number of transactions resulting in second requests declined, and the percentage and number of successful early termination requests increased.
**Price Discrimination**

Section two of the Clayton Act, commonly known as the Robinson-Patman Act, was designed to protect small businesses from the buying and selling power of larger, more integrated businesses. In 1936, Section two was amended by the Robinson-Patman Amendments to create the current statute. The statute prohibits sellers from “discriminat[ing] in price between different purchasers of commodities of like grade and quality…where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly…”

In other words, the Robinson-Patman Act requires a seller to treat all competing purchasers equally without discrimination in price. The main provision prohibits a seller from charging purchasers different prices for the same goods, injuring smaller competitors by giving preferred customers an advantage in the product’s resale. Differences in price are interpreted to encompass differences in delivery terms, rebates, service charges, etc.

Some exceptions to Robinson-Patman’s rule against price discrimination exist. The "meeting competition" defense permits the seller to charge a lower price to one customer if done in good faith in order to meet (but not best) an equally low price offered to that customer by the seller's competitor. Sellers should document the competitor's low price if relying on this defense. Second is the "cost justification" defense, which permits a seller to charge a different price to a customer if it reflects an actual difference in the cost of serving that customer. This defense is extremely difficult to prove, may involve complex cost accounting and economic theories, and should only be relied on when documented in advance.

Economists have frequently complained that price discrimination under the Robinson-Patman Act actually means a price difference, and has little or nothing to do with true economic price discrimination. See FTC v. Anheuser-Busch, Inc., 363 US 536, 80 S.Ct. 1267 (1960). The statute is designed to condemn differential pricing (selling the same product to two different buyers at two different prices regardless of cost) rather than true price discrimination (whenever two different sales produce two different ratios of price to marginal cost). It reaches some cases of price discrimination that are also cases of differential pricing; however, the Act can also condemn differential pricing which is non-discriminatory because the ratio of price to marginal cost is the same even though price is different.

Amazon’s recent use of dynamic pricing <see http://www.stern.nyu.edu/~lcabral/ufm/examples/Amazon_dot_com.html> to charge certain consumers more for certain products is an example of economic price discrimination because it charges consumers based on their willingness to pay rather than the cost of serving them. Whether dynamic pricing will actually trigger prosecution under
the Robinson-Putnam Act is unclear, however, because it constitutes price discrimination against consumers, rather than against small businesses.

Another example of economic price discrimination is Coca-Cola’s practice of charging different prices in different territories <http://luiscabral.org/iio/ch10/coke>. Because of Coca-Cola’s practices, bottlers outside the territory can often ship their beverages into the territory and charge a lower price than that of the designated bottler. Coca-Cola uses strictly-enforced territorial restrictions to combat this tactic.
Collusion and Cartels

Two of the earliest and most important functions of the antitrust laws are the prevention of price-fixing (collusion) among competitors and the creation of cartels. Section one of the Sherman Act, which regulates vertical restraints, also regulates so-called “horizontal restraints” between competitors. Horizontal restraints are, however, treated much more harshly than their vertical cousins.

Agreements between competitors to fix, raise, lower, stabilize or peg prices, or establish a range of prices, a minimum price, a maximum price, or a common pricing system are all unlawful per se. Bid-rigging schemes also violate the Sherman Act's price fixing ban. Thus, agreements between competitors to fix or refrain from bidding or arrange other collusive bidding schemes are unlawful.

Agreements between competitors that do not concern prices directly but that impact prices nonetheless have also been held unlawful. Thus an agreement among competitors to buy certain amounts of goods is unlawful because it decreases market supply and thus increases price. Similarly, establishing a limit on the level of sales in order to limit supply (and thus increase price) also violates the Sherman Act.

Collusion between competitors is also forbidden with respect to terms and conditions of sale. Competitors may not agree on customer credit terms, discounts, service charges, restocking charges, delivery charges and terms, product warranties, rebates or taxes. Competitors are also prohibited from collectively setting an open pricing policy in which each party adheres to announced prices and terms, regardless of whether competitor independently determined the price for its product.

In recent years, there have been two high-profile price-fixing cases. The first case occurred in 1998, when the government convicted two former executives of Archer Daniels Midland of conspiring with Asian competitors to fix prices for lysine (a feed additive). Two years later, in October 2000, the former chief executive officers of Sotheby’s Holdings and Christie’s International were indicted for fixing the prices of commissions charged to sellers.

Because price-fixing and bid-rigging are "naked" restraints (i.e., price fixing is not accompanied by any integration of the firms’ other business), and are per se illegal under the Sherman Act, there are no formal guidelines about which cases the DOJ prosecute. The intensity with which price-fixing is enforced depends on the politics and policies of the administration. The vigor with which the Bush Administration pursues price-fixing remains to be seen.
Predation and Other Exclusionary Practices

If market structure defines a monopolist and provides its power, then it would make sense for companies to manipulate its market’s structure to further its market power. Efforts by a company to increase or maintain its market power are called “monopolization,” and are unlawful under section two of the Sherman Act.

The modern formulation of the offense of monopolization, defined in United States v. Grinnell, 384 U.S. 563 (1966) is (1) the possession of monopoly power in the relevant market, and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.

Market power has already been defined in Business Combinations as the power to reduce output and raise prices above marginal cost, and to make a profit by doing so. “Monopoly power” is simply a large amount of market power. Thus the discussion shall focus on the second element of monopolization, ‘acquisition or maintenance’ of monopoly power. Such actions are referred to as “exclusionary practices,” the most familiar of which is predatory pricing.

Not all behaviors that are exclusionary or injurious to competitors, however, are impermissible. The courts distinguish between efficient and competitive conduct with an exclusionary effect and genuinely anticompetitive exclusionary practices.

Illustrative Exclusionary Practices

A wide variety of practices have been condemned by the courts under section two of the Sherman Act. The list of such practices is both expanding and retracting: new exclusionary practices are frequently identified by courts, while practices once found anticompetitive are often deemed harmless or even efficient when subjected to modern economic analysis.

Predatory Pricing

Predatory pricing refers to a firm’s attempt to drive a competitor out of business, or to discourage a potential competitor from entering the market, by increasing its output and selling at an “artificially” low price. The concern of anti-trust laws is that once the rival is dispatched, the predator will be able to reap monopoly profits that more than pay for prior losses.

Because low prices and high output are among the most important goals of the antitrust laws, predatory pricing presents the courts with the difficult dilemma of assessing when the combination of low prices and high output have become “too much of a good thing.”
Areeda-Turner Test
The Areeda-Turner test is the most frequently applied test for determining whether a pricing scheme is predatory. The Areeda-Turner test states that for a monopolist, any price below average variable cost should be conclusively presumed predatory, any price above average variable cost should be (rebuttable) presumed nonpredatory, and any price above average total cost should be conclusively presumed nonpredatory.

Plausibility of Predatory Pricing
In recent years, the antitrust authorities have realized that predatory pricing is only economically plausible in certain circumstances. While court performance remains mixed, the FTC has been generally consistent when analyzing the following structural issues in antitrust cases:

- Predatory pricing is not plausible in markets containing low entry barriers, because when the predator attempts to “recoup” by raising prices, new rivals will flood the market.
- Likewise, predatory pricing is implausible in declining industries with significant overcapacity. In such industries, all firms will increase capacity and reduce prices, but even as competitors cease to exist, the surviving firms cannot achieve monopoly profits because when they raise prices, their rivals can increase capacity.
- Finally, predatory pricing is implausible where the predator does not have an extremely high market share – on the order of 70% or more. This implausibility results from the predator’s need to assume all of its prey’s lost sales, losing money on every sale as long as the predation continues. A firm with 80% market share might be able to increase its output by 20% to crush a small competitor, but a firm with 30% market share will probably not be able to triple capacity and suffer losses on each sale.

Purchase and Shutdown of Rival’s Plants
Traditionally, purchase and shutdown of a rival’s plants has been considered illegal monopolization, particularly in the famous Standard Oil case (Standard Oil Co. of N.J. v. U.S., 221 U.S. 1, 31 S.Ct. 502 (1911). The shutdown of the purchased plant effectively reduces market capacity. The modern view is that such behavior invites new entrants into the market, unless actual overcapacity existed in the market before the shutdown – in which case the purchase and shutdown was efficient behavior.

Capacity Expansion
A monopolist in an industry subject to economies of scale can deter new entry by building more capacity than it intends to use; the effect is to deter rivals who know that entry can be met by an immediate increase in output and lower prices. In practice, the law has sometimes condemned a monopolist for building capacity it actually intends to use –
in the famous *Alcoa* case, Alcoa was condemned for expanding capacity to meet anticipated increases in demand. (U.S. v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

**Predatory R&D**

Many recent monopoly cases (*IBM, Eastman Kodak*) have involved claims of “predatory” R&D, alleging the introduction of new products that destroy the business of a competitor, and the failure to predisclose new innovations. Such behavior is literally exclusionary, because it may drive competitors out of the industry, but it is also efficient and highly desirable – so courts have not typically treated R&D as anticompetitive. For example, in 1979, IBM was brought to court on the charge that it was injuring independent memory manufacturers whose devices were no longer compatible with IBM’s new generation of computers which had different memory devices. However, the court exonerated IBM, holding that by limiting a monopolist’s right to introduce new products and engage in R&D technological progress would be harmed.

**Patent Abuse**

A monopolist’s tying of unpatented products to its patented products is generally condemned. On the other hand, accumulating patents in a market to render competition by other firms more difficult is generally deemed legal. The overlap between patents (and other intellectual property) with the antitrust laws is a complex area covered in more depth in *Intellectual Property*, below.

**“Essential Facilities”**

A dominant firm that controls an “essential facility” may have a duty to share the facility with competitors. The precise definition of an essential facility is unclear, but it must be a productive asset that is essential to operation and cannot be duplicated. A firm controlling an essential facility does not have to share it if doing so will impair or undermine its own business. For instance, in Fishman v. Estate of Wirtz, 807 F.2d 520 (7th Cir. 1986), the courts held that a public sports stadium could be an essential facility if it could not be duplicated.

**Other Tactics**

New exclusionary practices frequently arise. For example, the FTC is investigating two major pharmaceutical firms for paying manufacturers of generic drugs to stay out of their markets, reducing competition and allowing the firms to maintain high prices for their brand-name products <see [http://luiscabral.org/iio/ch15/generics/](http://luiscabral.org/iio/ch15/generics/).>
Intellectual Property

U.S. antitrust and intellectual property laws often appear incompatible. Although antitrust laws encourage competition and prohibit monopolies, intellectual property laws grant their owners legal monopolies. For this reason, the interplay of antitrust and intellectual property laws has always presented formidable problems, and a comparison of antitrust and intellectual property continues to challenge the courts. Thus, understanding the relationship between the two seemingly inconsistent policies and the ongoing development and change in this relationship is important in the current IP-reliant businesses environment.

The scope of intellectual property rights has come before the courts since the signing of the Sherman Act in 1890. Each body of law implicates the other, but their basic tenets appear irreconcilable. A claim by a plaintiff that a competitor has infringed upon a patent or copyright often invites a counterclaim alleging that the plaintiff is misusing the patent and copyright in an anti-competitive manner. In other instances, a claim of anti-competitive conduct is greeted by the defense that the alleged conduct is justified in protecting intellectual property rights. Courts struggle to adopt rules maximizing intellectual property rights while minimizing the degree to which those rights displace or undermine antitrust policy.

Substantial efforts by the DOJ and the FTC on the areas where antitrust law and intellectual property law overlap illustrate the growing importance of intellectual property to both national and international commerce. Increasingly, deals concerning transfers and licensing of intellectual property are among the largest and most important transactions in the national and global economies.

Determining how this conflict will be resolved is difficult if not impossible until the Supreme Court reviews a lawsuit between Xerox Corporation and independent photocopier service people. The independents allege that Xerox violated antitrust law when it denied access to Xerox parts necessary for servicing Xerox-brand photocopiers. The independents argued that Xerox attempted to monopolize the service market for Xerox machines and that the alleged conduct is justified in protecting intellectual property rights. Although the independents prevailed in federal district court, Xerox appealed the decision to the Court of Appeals for the Federal Circuit, which reversed the lower court’s ruling in April 2000. Xerox contended that it justified denied access to the parts for which it maintained patents and copyrights, and that it had the absolute right to deny access to its intellectual property, not withstanding the Sherman Act. Through this decision the Federal Circuit created antitrust immunity for owners of intellectual property who decide not to deal with competitors.

1 The Federal Circuit Court of Appeal was created to deal exclusively with intellectual property cases and thus its pronouncements on intellectual property control. However, the Federal Circuit does not have any recognized expertise in antitrust law.
In the 1980s, independent operators of Kodak machines brought a similar lawsuit against Kodak. However, despite Kodak’s identical argument that the intellectual property rights embodied in their Kodak parts permitted them to deny access to whomever they chose, the independents prevailed in their lawsuit, and obtained a judgment of several million dollars in 1996. The United States Court of Appeals for the Ninth Circuit rejected Kodak’s argument, reasoning that while ownership of intellectual property included the right not to license or transfer intellectual property, it could not be used to obtain immunity from antitrust laws.

Because of the conflicting opinions between the courts’ review of the Kodak and Xerox cases the Xerox case befits review by the Supreme Court. If the Supreme Court affirms the Federal Circuit's opinion in the Xerox case, owners of intellectual property will be relatively immune in antitrust litigation. Microsoft would have a powerful defense in many aspects of its suit if intellectual property ownership provides some degree of antitrust immunity. However, the Ninth Circuit Court of Appeals’ decision enjoys the greater weight of case law and more persuasive arguments on its side, and Supreme Court review is expected to result in a reversal of the Federal Circuit Court of Appeals.

The question of ownership of intellectual property poses unusual problems for determining antitrust liability. Although the two sets of rules both promote innovation and enhance consumer welfare, their methodologies are different. The obvious contradiction is that intellectual property rights confer a monopoly to promote scientific and artistic advancement while antitrust laws prohibit monopolies in order to enhance economic efficiency. Antitrust laws combat market power or the power to control supply and price in a market. But it does not follow that an intellectual property monopolist who has a patent on a particular process or machine or a copyright on software has the power to control a market. In many instances, the intellectual property owner only controls one production method. Ownership of one production method does not confer the ability to control a market.

**IP Licensing Guidelines**

Antitrust concerns often arise when a licensing arrangement undermines competition among entities that would have been actual or likely competitors in a relevant market in the absence of the license. In order to assist businesses in determining which intellectual property practices are anti-competitive, the FTC and DOJ jointly created guidelines delineating the antitrust enforcement policy of the agencies with respect to the licensing of protected intellectual property.

The guidelines as drafted embody three general principles:

i. Intellectual property is like other forms of property and thus standard antitrust analysis applies. In addition, the analysis must consider the differences among patents, copyrights, and trade secrets when evaluating the specific market circumstances in which transactions occur.
ii. The agencies do not assume that intellectual property creates market power\(^2\) in the antitrust context. For example, market power that is acquired through “a superior product, business acumen, or historic accident” does not violate the antitrust laws.

iii. The agencies realize that intellectual property licensing allows firms to combine complementary factors of production and generally furthers competition. This combination increases the anticipated returns from intellectual property, ultimately increasing the incentive for the creation and promotion of greater investment in research and development. Exclusivity provides an incentive for a licensee to invest in the creation of additional applications for, and distribution and commercialization of, products developed from the licensed intellectual property.

Restraints in intellectual property licensing arrangements are typically evaluated by assessing whether anti-competitive effects will likely result, and if so, whether these restraints achieve greater pro-competitive effects. Additionally, the FTC and DOJ use the “Rule of Reason” to evaluate whether a licensing relationship is primarily vertical or horizontal, or whether the relationship embodies aspects of both licensing arrangements.

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\(^2\) Market power is the ability to profitably maintain prices above, or output below, competitive levels for a significant period.
International Aspects

European Community Competition Policy

With the U.S. now adopting a more restrained antitrust enforcement policy, European Union (EU) competition chief Mario Monti is likely the world's most feared trustbuster. For example, while it appears that the U.S. courts may allow Microsoft Corp. to continue in its current form with only minor penalties, the E.U. is pressing a widespread investigation of Microsoft’s business practices that may result in serious penalties. Moreover, Intel has been scrutinized by E.U. officials regarding its marketing and licensing tactics, despite having been cleared by the FTC.

Monti has also been investigating mergers – even those involving only U.S. companies. For example, General Electric Co.’s proposed union with Honeywell International Inc. was reviewed by the E.U. because the merged company would sell more than $225 million annually in Europe. Despite a personal plea from GE Chairman John F. Welch, who flew to Brussels to meet with Monti, the E.U. antitrust chief forced the dissolution of the deal. Commenting on his February 2001 meeting with Welch, Monti said, "He is right to give himself a bad grade for predicting the merger would get through."

U.S. companies are now realizing that Europe may now have more power to derail a deal than U.S. antitrust regulators. Whereas in the U.S., antitrust law favors consumers over competitors, the Europeans are more likely to heed complaints from competitors only. Europe's Microsoft investigation—which, unlike the U.S. antitrust battle, focuses on the market for so-called server software—has been largely instigated by Microsoft’s competitor Sun Microsystems Inc. Likewise, the GE-Honeywell deal was challenged by rival aerospace companies including United Technologies and Rockwell, as well as Rolls-Royce PLC.

Europe's interest in antitrust dates back to the 1980s, when regulators started privatizing national monopolies, opening markets, and cracking down on industry cartels. Because many of the EU's laws were modeled after U.S. laws, Europe and the U.S. have rarely disagreed about antitrust cases previously. In fact, only the 1997 merger between Boeing Co. and McDonnell Douglas caused friction—the deal was cleared by the FTC and initially opposed by the E.U. U.S. politicians threatened a trade war, and the Europeans did not back down until top Clinton Administration officials intervened. Nonetheless, the Boeing transaction proved that disagreements between antitrust authorities can be volatile.

Now that President Bush’s appointees have assumed their positions at the FTC and DOJ, experts predict more situations like Boeing-McDonnell Douglas, resulting in increased tensions between the U.S. and the E.U. over antitrust doctrine. "From the beginning of time until now, it has been the U.S. authorities leading antitrust," says Pontus Lindfelt, an antitrust attorney at the Brussels office of U.S.-based law firm White & Case. "Maybe
now, for the first time in history, Europe will take the lead."

Nonetheless, the Boeing-McDonnell Douglas case illustrated that E.U. authorities have made efforts to avoid transatlantic controversy. Moreover, Monti’s power is limited by the EC’s lack of independent authority, as its power stems from its 15 member states. Thus, Monti must have all of his major decisions approved by agencies that may have conflicting objectives and legal interpretations.

Nonetheless, last year, Monti rejected the Volvo-Scania merger despite a visit from Swedish Prime Minister Goran Persson, who lobbied heavily for approval. Further, the Europeans have confirmed their willingness to anger large U.S. corporations, most recently GE and Honeywell. Additionally, in 1998, Monti’s predecessor, Karel Van Miert, forced MCI Communications and WorldCom to divest part of their internet backbone operations.

In fact, in some respects Monti appears to have more power than his U.S. counterparts at the DOJ and FTC. Indeed, Monti can halt a merger without bringing the companies to court. He can also rely on European competition laws that are far more stringent than those in the U.S. For example, under a concept known as "collective dominance," the E.U. can derail a merger that shrinks an industry with five players to four—a scenario that U.S. antitrust law tolerates. More importantly, the Europeans have become far more comfortable with antitrust law and are enforcing it more confidently.

**Background**

In 1950, a common European market for iron, coal, and steel was proposed to integrate the European economy, offering European companies larger markets and generating increased competition among producers.

With the Treaty of Paris, basic merger controls were established, aimed at fostering competitive behavior, establishing basic merger controls, and prohibiting discriminatory pricing, restrictive delivery arrangements, exclusive dealing contracts, price fixing among companies, output agreements among companies, and other practices that facilitated market sharing.

In 1957, the European Economic Community (EEC) was formed through the Treaty of Rome. The Treaty of Rome is the precursor of today's 15-state union, and established the legal framework for competition policy in the E.U. The Treaty expanded the common market beyond the original three commodities (iron, coal and steel) to all industries.

**Comparison to U.S. Antitrust Law**

Unlike the U.S., the primary goal of competition policy in the E.U. is to integrate the European community, benefiting consumers by making products available at lower prices
and benefiting manufacturers by providing access to more consumers. This goal stems partly from the European notion that competition cannot achieve a desirable objective, or does so only at unacceptable social costs.

Two articles within the Treaty of Rome form the basis of E.U. competition policy. Article 85 regulates horizontal business relationships while Article 86 regulates the abuse of power in vertical business associations. Merger Regulations, adopted in 1990, provide the basis for merger control within the EU and establish Commission jurisdiction over mergers and acquisitions.

**Article 85**

Like the Sherman Act, Article 85 prohibits agreements between firms that negatively impact or intend to diminish competition. Article 85 also prohibits the following agreements:

- price fixing or trading conditions;
- fixing output, markets, technological development, or investment;
- dividing markets or sources of supply;
- engaging in price discrimination; and
- establishing contractual conditions having no bearing on the contract’s subject, such as tie-in clauses.

However, if these agreements improve “the production or distribution of goods” or aid “technical or economic progress” and also benefit consumers, they are exempted under Article 85. These exemptions apply only if the agreement’s restrictions are narrow, and the agreement proves beneficial without eliminating competition.

As with the Sherman Act, certain types of behavior are per se illegal under the Articles and thus are prohibited unless an exemption applies. However, the proscriptions under Article 85 are both more and less restrictive than the prohibitions under the Sherman Act. For example, under the Sherman Act, an agreement to fix technological development is considered legal unless an anticompetitive effect is identified; in the E.U. such an agreement is per se illegal. On the other hand, certain behaviors that are deemed per se illegal under the Sherman Act, such as price fixing, may qualify for an exemption under Article 85.

**Article 86**

Article 86 is analogous to the U.S. prohibition on monopolization although it does not forbid the existence of a dominant firm, but the Article does not mention the word “monopoly.” Instead, Article 86 regulates the behavior of firms holding “dominant position[s],” and thus prohibits the following “abusive” conduct:
• setting unfair trading terms, such as purchase or sale prices;
• limiting production, markets, or technological development harming consumers;
• applying different terms to different trading partners; and
• establishing contractual conditions having no connection to the contract.

Despite differences, any violation of the Sherman Act apparently would also violate Article 86. However, the reverse is not true—activities considered “abusive conduct” under Article 86 do not approach the level of unlawful monopolization under the Sherman Act. Additionally, U.S. law is only concerned with effects on competition whereas Article 86 expressly considers the interests of business and consumers.

1990 Merger Regulation

The 1990 Merger Regulation provided the EC jurisdiction over concentrations—mergers, acquisitions, and joint ventures—with a “Community dimension,” including: (1) parties with combined worldwide turnover greater than ECU 5 billion ($6.5 billion), (2) E.U.-wide turnover of at least two parties of ECU 250 million ($325 million) each, and (3) no party to the transaction achieved more than 2/3 of their turnover in a single Member State.

The Merger Regulation, like the HSR Act, requires merging parties with a Community dimension to notify the EC of the arrangement and sets the deadline for notification at one week after the signing of the agreement, the announcement of the public bid, or the acquisition of the controlling interest. Deals are essentially suspended temporarily after notification until the EC can appraise the concentration. The Commission can deem concentrations that create or strengthen a dominant position as “incompatible with the common market.” Criteria the EC considers when examining a concentration include the following:

• the need to maintain effective competition within the common market;
• market power of the firms involved;
• available substitutes;
• barriers to entry;
• supply and demand conditions for the goods/services at issue;
• interests of intermediate and ultimate consumers; and
• the development of technical and economic progress benefitting consumers which does not hinder competition.

The Commission regulates only “community dimension” concentrations. Other concentrations are investigated by E.U. Member States. Two exceptions exist: (1) concentrations with a Community dimension can be investigated by a Member State if the harm to their domestic competition is great, and (2) a Member State can petition to investigate a concentration falling below threshold requirements if the concentration results in a dominant position damaging to a state.
Negative Clearance

Unique to E.U. antitrust law is the “negative clearance” doctrine. Firms can file for negative clearance by notifying the Commission of a concentration or transaction that might violate Article 85 or 86. When the Commission approves a transaction, it issues a declaration affirming that the transaction did not violate Article 85 or 86. However, the process necessary to obtain approval is time consuming and risky. Also, by notifying the EC of the agreement, firms may unnecessarily draw attention to an agreement that would have otherwise gone unnoticed by the Commission. A less lengthy option to the negative clearance letter is solicitation of a “comfort letter” from the Commission. While comfort letters are not legally binding, as are negative clearances, they indicate the Commission’s probable position on a transaction. Most cases are dealt with via comfort letters, however, it has been proposed that comfort letters be converted to binding decisions. Additionally, the Commission will sometimes grant “block exemptions,” for franchising agreements, patent licensing, or other common business situations.

Enforcement

Both the Member States and the E.U. have jurisdiction over most types of behaviors by firms within their boundaries. But, when the E.U. exercises jurisdiction over a matter, Members States are expected to relinquish jurisdiction. While E.U. competition policy only applies to cases that “affect trade between Member States,” this definition if far from unambiguous. The problem is that Member States have different opinions on the proper scope of E.U. and Member State jurisdiction.

The European Commission examines cases from three sources: complaints made by third parties, notification of an agreement, and through its own initiative. In 1993, 404 cases came before the EC; 65% of these cases were notifications, 26% stemmed from complaints filed, and the remaining 9% were brought under the Commission’s own initiative. Complaints filed by third parties ranged from instances of small companies seeking protection to large companies seeking to hold off competitors through a bureaucratic investigation. If the E.U., after investigation, decides to act, it may either (1) issue a recommendation to an infringing company, or (2) initiate formal proceedings. The Commission often issues a recommendation before taking formal action.

Penalties for violations of the Treaty of Rome, such as articles 85 and 86, entail monetary fines of up to $1 million ECU ($1.3 million USD). Fines may be increased above this boundary, but cannot exceed 10% of the firm’s annual revenues. The EC determines the size of the fine based on the severity of the infringement. At the end of 1993, 1,250 cases were under review, 404 of which had been brought that year. Since the adoption of the 1990 Merger Regulation, the EC has reviewed about 70 to 80 transactions annually, though roughly only 10% have gone to formal proceedings.
Example

In 1978 the Commission charged United Brands Company (UBC) with price discrimination. UBC, an American company holding approximately 45% market share in Europe, exported bananas under the Chiquita brand from South America to Europe. UBC sold the bananas to European distributors and allowed the distributors to resell the bananas among themselves during the brief period when the bananas were ripe. The prices distributors paid to UBC varied by as much as 50%, and were based on demand conditions in the distributors’ end markets. UBC required the distributors to pay shipping charges from UBC offices in Rotterdam or Bremerhaven.

UBC argued that the price differentials charged distributors were based on different conditions in the distributors’ markets, but the Commission rejected the defense and stated that because the distributors bore the risks in their respective markets and all bought the same product in the same place, UBC could only take different market conditions into account to a limited extent.

Japanese Competition Policy

Background

Before the American occupation of Japan after World War II, Japan had no formal competition policy. The industrialization of Japan was stimulated by government-controlled companies and government assistance to zaibatsu, large business conglomerates.

The government guided industrial development by encouraging mergers, allowing monopolies and fixing prices. Indeed, the government targeted industries for consolidation and enforced mergers and reorganizations. Industries that experienced consolidation included the iron and steel, finance, maritime, paper and the automotive industries. By 1945, one company, Oji Paper controlled 96% of the pulp and 85% of the total paper production in Japan. Moreover, the largest four zaibatsu controlled 544 companies, totaling almost 25% of all businesses in Japan. Even industries not controlled by zaibatsu tended toward monopoly or at least oligopoly.

Japan’s first antitrust laws were enacted after the war during the U.S. occupation of Japan. The U.S. enacted the Deconcentration Law of 1947, which split large, monopolistic companies into smaller companies. The Anti-Monopoly Law (AML) was then passed in 1947, and supervised its strict enforcement until April 1952 when Japan regained its sovereignty. Under the AML, cartels were presumed illegal except upon a showing of negligible effects on competition. Monopolies were essentially declared per se illegal because the AML prohibited “undue imbalance in business powers.” This prohibition ensured no individual company could hold significantly more market share or production capacity than other companies in its market. The AML also restricted mergers
and corporate stock ownership, and granted the Japan Fair Trade Commission (JFTC), modeled after the FTC, the power to dissolve or break-up dominant firms.

Other statutes gave the Ministry of International Trade and Industry (MITI) the power to sanction export and import cartels and small business cartels, and specifically disavowed the authority of the JFTC to approve or reject cartels. MITI took the lead in formulating and enforcing economic policy designed to revitalize industrial growth by encouraging price and production cartel agreements and mergers in major industries. Cartelization sponsored by MITI became commonplace during these decades, and MITI’s influence led to the formation of export cartels, recession cartels, and rationalization cartels. MITI also regularly utilized administrative guidance (kankoku sotan) to limit production, justifying such guidance on the basis of inherent agency power.

Summary of Current Laws

Japanese competition policy focuses largely on three areas of unacceptable conduct: (1) monopoly, (2) cartels and unreasonable restraint of trade, and (3) unfair business practices. The AML also encompasses structural policy and addresses the legality of mergers.

Monopoly
Modeled after the Sherman Act, the AML prohibits monopolization, including conduct that restraints competition, is exclusionary, or otherwise enables monopoly development (i.e., predatory pricing, exclusive dealing, or tying arrangements with dealers or distributors). The AML’s authority, however, extends beyond conduct to the prohibition of monopolization resulting from technological innovation or natural growth. In such situations, the JFTC can control the monopolized market. The AML classifies a monopolized market as one in which (1) sales in the market exceed $50 billion yen, (2) barriers to entry are high, (3) prices are rigid, (4) one company has a market share of 50% or greater, and (5) the monopolist earns excess profits or incurs excess expenses. Currently, the JFTC may take deconcentration measures preventively on the theory that the market structure itself restrains competition. However, the JFTC rarely exercises its broad powers.

Cartels and Unreasonable Restraint of Trade
The AML prohibits anti-competitive conduct in horizontal relationships and thus forbids cartel agreements to “fix, maintain, or increase prices, or to limit production, technology, products, facilities, or customers or suppliers, thereby restraining, contrary to public interest, substantially, competition in any particular field of trade.” However, the AML does not per se ban cartels—the proscription does not include such cartels as depression cartels, export- or import-cartels, or small business cartels.

MITI and the JFTC do not have the same opinion regarding the meaning of the “public interest” as it applies to cartels. JFTC officials believe that “public interest” prohibits anti-competitive conduct. In contrast, MITI officials contend that even at the expense of
anticompetitive conduct, cooperation and coordination should advance the economic
development of Japan. MITI’s influence is greater within the Japanese government as
demonstrated by the existence of hundreds of legal cartels, and the commonality of unregulated keiretsu arrangements between buyers and sellers.

Unfair Business Practices and Vertical Relationships
The following activities are deemed illegal under the AML:

- Unreasonable discrimination (price discrimination, boycotts);
- Unreasonable (including predatory) pricing;
- Unreasonable inducement and coercion of customers (tying arrangements);
- Refusal to deal, RPM, territorial restrictions;
- Abuse of dominant market position or bargaining power; and
- Unjust interference in the affairs of competitors.

The proscription against “unfair business practices” apparently serves as a preventive measure against monopolization, advances consumer protection, and acts as an influential portion of Japan’s small business law. These proscriptions champion small enterprises, which are more susceptible to the abuses of economic power and underhanded economic activities undertaken by larger enterprises.

Structural Policy
Like the HSR Act, the AML requires merger parties to notify the JFTC, and the parties must wait 30 days after the JFTC is notified before the parties may consummate the merger; allowing the JFTC to investigate the transaction.

Mergers of companies with total assets of less than five billion yen (roughly $55 million) usually do not require extensive review by the JFTC. Companies with assets in excess of 5 billion yen, however, are closely scrutinized under the following circumstances:

- the market share of any party or of the combined parties totals 25% or more;
- the merger involves the largest firm in a market and that firm’s shares equals 15% or more;
- the merger involves the largest firm and the difference in market share between the largest firm and the second- or third-largest firm is “substantial”;
- the merger involves any of the three market share leaders in a market, and the market share of the largest three firms totals 50% or more;
- the number of competitors to the merged company is “considerably small”;
  or
- the total assets of any party to the merger amounts to 100 billion yen (roughly $1.1 billion) or more and the total assets of another party to the merger amounts to 10 billion yen or more.

Also, similarly to the FTC and DOJ, the JFTC determines the degree of market competition by considering the number of competitors in a market, competitors’ market shares, barriers to entry, and substitutability of goods.
**Enforcement**

Antitrust enforcement in Japan has been weak mostly due to the political imbalance between the respective enforcement powers of the JFTC and the MITI. As mentioned above, despite being specifically created to enforce antitrust law, the JFTC has less influence over policy than does MITI. The head of MITI is appointed by the Japanese Prime Minister and guides the country’s commercial and industrial development.

For example, in the 1980s the JFTC and MITI clashed over competition in the Japanese oil refining industry. Under MITI’s guidance, the major oil refiners formed a cartel setting the amount of crude oil refined by each. The JFTC concluded that the arrangement violated competition laws, and prosecuted the company directors. The Supreme Court of Japan rejected the claim by the oil refiners that administrative guidance provided by the MITI authorized the cartel, and deemed the cartel illegal. The Court did not, however, specifically rule that the AML takes precedence over a ministry’s administrative guidance, leaving such a defense to an industry challenged in a future litigation.

The United States DOJ and Trade Representative are constantly pressuring Japan to ‘improve’ the content and enforcement of its competition law because of the expected resulting increase in the ability of U.S. companies to compete successfully in Japan. For an example of recent political pressure and a clear clash of competition philosophies, see the DOJ’s comments on Japan’s new laws regulating trade associations. <http://gopher.usdoj.gov:70/0/atrinternational/jftc.txt>.

**Comparison to U.S. Antitrust Laws**

On its face, the AML parallels U.S. antitrust law in many respects. Nonetheless, the major difference between the two guidelines is the lack of private enforcement of the AML. In the U.S. weak enforcement by the DOJ or FTC can be largely overridden by enforcement of private parties prosecuting under the treble damages provisions, whereas in Japan, enforcement rests solely with the government, which typically is more interested in Japanese firms’ competitiveness in the international markets.

**Additional Reading**

For more information on International Antitrust Law from around the world see: http://members.aol.com/Rudolaw/IA2.html
Common Sense Guidelines

The antitrust law is complex, and if any antitrust situation arises, the best advice is always to consult a competent lawyer specializing in the field. To minimize the number of such situations that do arise, businesspeople would be wise to heed the following list of “do’s” and “don’ts”.

Do -

Compete for all the business you can get. Success is not unlawful; big is not illegal. Adopt any new marketing or pricing strategies for which you have a sound business justification. If you have better or cheaper products, do not be afraid to use those efficiencies to gain market share.

Consider the effect on competitors of any planned action, especially if you possess market power. (Recall that market power can be measured either by your share of the market or by the power to set prices.) If a planned action is likely to hurt your competitors, be sure to have a sound business justification grounded in benefits to consumers.

Suggest retail prices to your vendors, so long as you do not coerce them to accept those prices. You are permitted to use suggested price lists and promotional literature mentioning price, but extracting agreements to charge that price, or threatening cancellation of relationships if vendors do not accept your suggestions, is risky.

Be on guard at trade association functions. While memberships in trade associations that engage in activities that do not diminish the intensity of your competition with others in the industry are perfectly acceptable, beware of meetings with competitors that result in discussions of business tactics, customers, costs, and ultimately prices. If a trade association meeting turns to any topic that might be construed as price-fixing or market-sharing, leave immediately.

Impose restrictions on your vendors if they contribute to your ability to compete with rival brands. The antitrust laws are primarily interested in inter-brand competition, so restrictions on intra-brand competition are viewed more favorably.

Use exclusive dealing arrangements if they are justified by business necessity. But you will need a compelling business justification if your market share is very high or if the agreement is for a long term.

Charge all customers the same price. The only exceptions are if the cost of serving them varies, or if you need to cut prices to meet the lower prices of a competitor.
Implement an antitrust compliance program customized for your business. Leadership from the top on antitrust issues can prevent the antitrust authorities and private plaintiffs from bringing large damage claims, fines, and even jail terms against you.

Don’t -

Discuss prices with your competitors. Ever. The antitrust authorities will bring criminal charges if they learn of such discussions, and jail time may result.

Agree with your competitor to divide up the market. If discovered, the likely result will be harsh fines and/or criminal prosecution.

Join forces with some competitors if it disadvantages a few others. Although some forms of cooperation, such as joint research and development activities, are permissible if their main purpose is to improve efficiency, others, especially those that deny the excluded competitor access to an essential facility on reasonable terms, are more questionable. This is a gray area; proceed with caution.

Price below cost if your intent is to drive out competition or discourage new entry. Another gray area; some below-cost pricing is acceptable (e.g. introductory offers or promotions), and the courts have never clearly defined what measure of cost should be used. Review any below-cost pricing strategies carefully, especially if you have a large market share.

Tie the sale of one product to another. Although tying arrangements are not per se unlawful, they frequently are deemed illegal.

Forget that the laws of Europe and other international jurisdictions may apply. Business combinations in particular are now exercises in international law.

Notes

Jacqueline (Jackie) Y. Fortinash prepared these notes under the supervision of David Backus and Luís Cabral. © 2001 David Backus and Luís Cabral.