JOINT COMMENTS OF THE AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW AND SECTION OF INTERNATIONAL LAW ON THE JAPAN FAIR TRADE COMMISSION'S DRAFT GUIDELINES ON EXCLUSIONARY PRIVATE MONOPOLIZATION UNDER THE ANTIMONOPOLY ACT

August 19, 2009

The views stated in this submission are presented jointly on behalf of these Sections only. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.

The Section of Antitrust Law and the Section of International Law of the American Bar Association (ABA) appreciate the opportunity to respond to the request for comments by the Japan Fair Trade Commission (JFTC) in respect of the JFTC's Draft of the "Guidelines for the Exclusionary Private Monopolization under the Antimonopoly Act" (Guidelines). The Sections appreciate the substantial thought and effort of the JFTC reflected in the Guidelines and take this opportunity to offer these comments in the hope that they may assist in the completion of the final Guidelines. The Sections are available to provide additional comments, or to participate in consultations with the JFTC, as appropriate. The Sections' comments reflect their expertise and experience with U.S. law and their familiarity with antitrust/competition law internationally, as well as expertise in the economics underlying the analysis of antitrust issues such as the abuse of monopoly power.

Executive Summary

The Sections commend and support the JFTC's issuance of and provision for public comment on the Guidelines. There is broad recognition of the need for clarity in enforcement principles with regard to unilateral exclusionary conduct, given the difficult questions and tradeoffs involved. While underinclusive enforcement standards can encourage anticompetitive conduct, vague or overbroad enforcement standards can "chill" legitimate competitive conduct beneficial to consumers and the economy. The Guidelines clearly reflect enforcement experience, careful study and a great deal of forethought in addressing these issues.

The Sections welcome this opportunity to submit these Comments. For the reasons explained below, the Sections provide several general comments on the approach taken in the Guidelines. First, the Sections suggest that enforcement concerns regarding possible exclusion focus upon the conduct of entities that possess substantial market power. This tends to conserve enforcement resources by directing them to where they are most likely to be needed and effective. Second, the Sections recommend that the Guidelines incorporate an explicit statement to the effect that the JFTC's enforcement policies in this area are aimed at preventing harm to the competitive process itself, rather than to any single entrepreneur. Third, the Sections recommend that the Guidelines' apparent reliance on "intent" as an indicator of exclusion be reduced or at least qualified by reference to more objective characteristics of competition, the challenged conduct and the actual and/or likely market effects of such conduct. Fourth, the Sections recommend additional clarification of certain terms. Finally, the Sections recommend explicit reliance on economic analysis in distinguishing between harmful exclusionary conduct warranting enforcement action and aggressive but lawful conduct.

The Sections also offer comments on the Guidelines' enforcement approach with respect to each of two specific forms of exclusionary conduct addressed in Part II – Refusal to Supply and Discriminatory Treatment, and Below-Cost Pricing. With respect to the first, the Sections identify specific policy considerations suggesting prudential limitation of circumstances in which Refusal to Supply can and should be attacked as exclusionary. The Sections suggest explicit recognition of these principles, as well as a number of specific clarifications of and modifications to particular aspects of the Guidelines' proposed approach. With respect to Below-Cost Pricing, the Sections suggest a number of clarifications, including a more precise definition of "cost" for purposes of identifying "below-cost pricing," a requirement that a likelihood of loss-recoupment through the acquisition of monopoly power be a prerequisite to liability, as well as a requirement of actual or likely harm to competition as distinct from mere harm to any specific competitor.

I. Introduction

Japan's Antimonopoly Act prohibits, among other types of anticompetitive conduct, "Exclusionary Private Monopolization" ("EPM"). EPM is defined as "excluding the business activities of other entrepreneurs . . . thereby causing, contrary to public interest, a substantial restraint of competition in any particular field of trade."[1]

As noted in the Guidelines, "in every competition process" a product or an entrepreneur "can naturally be driven out of the market as a result of business activities of other entrepreneurs."[2] It can therefore be difficult to distinguish problematic "Exclusionary Conduct" subject to antimonopoly regulation from market departures "resulting from normal business activities."[3] Indeed, the Sections believe that formulating mandates for unilateral conduct is among the most difficult and controversial tasks facing any competition authority.

The Sections therefore commend the Guidelines for clearly emphasizing the requirement that unilateral conduct should not be regarded as private monopolization unless such conduct effects a substantial restraint of competition in a particular field of trade. On the same basis the Sections also commend the principle that consumer welfare interests and potential efficiencies should be considered because they may justify certain conduct that might otherwise be deemed exclusionary. Punishing behavior that benefits consumers, such as a product innovation that accelerates the growth of a dominant firm at the expense of competitors, could result in economic stagnation and obstruction of sound competition policy objectives.

The Sections strongly support the issuance of these Guidelines to "ensure further transparency of law enforcement and improve predictability for entrepreneurs by clarifying" the factors that will be considered by the JFTC with respect to exclusionary private monopolization.[4] For the same reasons, the Sections recommend that the JFTC consider issuing further guidance with respect to (1) Unfair Trade Practices, in particular

[1] Tentative Translation of Draft of Guidelines on Exclusionary Private Monopolization under the Antimonopoly Act ("Guidelines") at p. 1.
[2] *Id*. at 1-2.
[3] *Id.* at 2.
[4] *Id.*

those now subject to surcharges; (2) "control"-type private monopolization; and (3) exercises of intellectual property that may constitute EPM.[5]

II. General Comments

A. Substantial Market Power Requirement

While the Guidelines recognize that a market participant with a large market share is more likely to be able to exclude rivals than a participant with a smaller market share,[6] they contain no threshold requirement of dominance or monopoly power as in other jurisdictions. The Sections suggest that a more explicit statement of a market power threshold would provide better guidance and more certainty to firms attempting to conform their conduct to the requirements of the Antimonopoly Act. Under U.S. law, for example, unlawful monopolization consists of (1) possession of monopoly power; and (2) acquisition, enhancement, or maintenance of that power through exclusionary conduct.[7] Monopoly power is therefore an initial threshold element of unlawful monopolization.

Furthermore, the Sections suggest that the JFTC clarify that a firm must have *substantial* market power before it can be found to have engaged in EPM. This threshold is widely accepted in other jurisdictions around the world, and is generally considered to be required to trigger the potential application of, for example, Section 2 of the Sherman Act, Article 82 of the Treaty of Rome, and the Chapter 2 Prohibition under the U.K.'s Competition Act.[8]

The requirement that a firm have *substantial* market power before it may be exposed to enforcement action under monopolization and abuse of dominance provisions recognizes that the intervention threshold (in terms of market power) for single-firm conduct should be higher than for mergers and agreements among competitors, to avoid chilling procompetitive single-firm behavior. The Guidelines rightly recognize "the difficulty in distinguishing Exclusionary Conduct from exclusions of other entrepreneurs resulting from normal business activities," and a substantial market power requirement would help reduce the risk of condemning procompetitive unilateral conduct.[9] This risk might be higher with the introduction of monetary penalties.

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[5] The Guidelines reference the JFTC's Guidelines for the Use of Intellectual Property under the Antimonopoly Act (Sept. 28, 2007) ("IP Guidelines"). However, it is unclear whether these are incorporated into the Guidelines and the Sections recommend updating the IP Guidelines now that surcharges can be imposed for exclusionary monopolization and unfair trade practices.

[6] Guidelines at 3, 35-37.

[7] *Verizon Communs. v. Law Offices of Curtis V. Trinko, LLP,* 540 U.S. 398, 407 (2004).

[8] Commission of the European Communities, *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* (February 9, 2009) at para. 10, available online at http://ec.europa.eu/competition/antitrust/art82/index.html ["*EC Guidance*"]; Sherman Act § 2, 15 U.S.C. § 2; Office of Fair Trading (United Kingdom), *Abuse of Dominant Position: Understanding Competition Law* (December 2004); available at http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft402.pdf, at para 4.11; *see also* International Competition Network, Unilateral Conduct Working Group, Recommended Practices on the Assessment of Dominance/Substantial Market Power, 2007-2008, at 1 ("Determining whether a firm possesses dominance/substantial market power generally is the first step in the evaluation of potentially anti-competitive unilateral conduct.").

[9] Indeed, every firm has some small degree of market power, even if only because of reputation, location, consumer preferences, and the like. Dennis V. Carlton, Market Definition: Use and Abuse, Competition Pol'y Int'l, Spring 2007, at 3, 7.

The Guidelines state that the JFTC's enforcement policy will be to "give priority" to matters in which the alleged monopolist has approximately 50% market share.[10] The Sections agree that employing a baseline market share test can be helpful as a first step when making enforcement decisions, but the Sections also suggest that the JFTC look beyond mere market share calculations when considering whether a firm has substantial market power. Substantial market power is commonly understood as the ability to control prices or exclude competition. Although a firm with a comparatively higher market share may be more likely than a firm with a lower share to possess such market power, other factors besides market share warrant consideration. For example, a firm may develop a superior product or win a bid in an auction market and find itself with a temporarily high market share, and even a temporary ability to charge a higher price. But if the market in which the firm competes has low barriers to entry and/or regular opportunities for rival firms to take share, or the firm's product can be imitated readily by competitors, or innovation is widespread and a rival reacts with a superior product, that high market share may not be sufficiently durable to constitute substantial market power—and, indeed, if entry barriers are low enough the firm would not be able to charge a supracompetitive price. Punishing a firm with a high market share but lacking the market power to sustain that share risks deterring the very conduct that sound competition policy is designed to encourage.

Moreover, the process of market definition and market share measurement -- both of which are necessary to ascertain the market share of any specific firm -- are often subject to difficult judgments and questions of degree. Specific market share calculations are therefore usually subject to a range of uncertainty, and this uncertainty should not be disregarded in making enforcement decisions.

B. Effect on Competition

The Antimonopoly Act requires a "substantial restraint of competition in a particular field of trade" to support a finding of exclusionary monopolization. The Guidelines appropriately note that this means the establishment, maintenance, or strengthening of a situation "in which competition itself has decreased."[11] However, the Guidelines cite to numerous illustrative examples of past monopolization decisions that do not clearly emphasize the effect on competition as a whole but instead could be read as focusing only on the harm to a particular entrepreneur.[12]

It is well-established that the fundamental purpose of antitrust laws is to protect the process of competition in the market, not individual competitors.[13] Consumer welfare is maximized when economic resources are efficiently allocated and when consumers are able to obtain products and services of competitive quality at competitive prices and other terms. Antitrust laws are therefore particularly concerned with acts that limit output or raise the price of goods above their competitive level or diminish their quality.

While this concept is impliedly incorporated in the requirement that there be a "substantial restraint of competition," the Sections recommend that the Guidelines explicitly

[10] Guidelines at 3.
[11] Guidelines at 35.
[12] *See, e.g.*, descriptions of Usen Corporation case (p. 6), Toyo Seikan case (p. 7), Hokkaido Shimbun case (p. 7). In addition, certain cited examples appear to be unfair trade practices cases, which do not require a showing of "substantial restraint of competition." *See, e.g.*, descriptions of Zenrin case (p. 12), Microsoft case (p. 24), and Toshiba Elevator Service case (p. 24).
[13] *See, e.g., Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993)

state that the purpose of the Antimonopoly Act is to protect competition, not competitors, and ensure that the illustrative examples clearly reflect this fundamental principle by explaining how competition as a whole has been harmed by the conduct at issue.

C. No Presumption Based on Intent

The Guidelines indicate that the intention to exclude business activities of other entrepreneurs "can be an important fact" leading to a "presumption" of exclusionary conduct.[14] Although intent sometimes can be indicative of the competitive consequences of conduct, such indirect indicators of harm to competition must be treated with caution. Specific and/or isolated verbalizations of business purpose by individuals are notoriously subject to mischaracterization and misuse in competition-law proceedings. Even the expression of aggressive intent by one firm regarding its competitors can be fully consistent with lawful competition.[15] Courts and scholars have recommended appropriately that the primary focus of competition-law enforcement policy and decisions regarding unilateral conduct remain firmly on the objective characteristics of the market, the impugned conduct, and the actual and likely effects of such conduct on the market. The Sections therefore suggest that the references to intent in the Guidelines, including in Part II Section 5(2)(E) on Refusal to Supply and Discriminatory Treatment, be re-phrased or at least be qualified by explicit reference to the primacy of these more reliable indicators of competitive effects.[16]

D. Need for Clear and Objective Standards

As indicated in the Guidelines, transparency and predictability are important to avoid a "chilling effect" on legitimate competition and undue interference with "fair and free business activity."[17] The Sections strongly support the value of transparency and predictability; in some sections, however, they recommend that the Guidelines could be improved in this respect by enhancing the clarity and objectivity of the standards.

For example:

- "Exclusionary Conduct" is described as conduct that is "highly likely to make it difficult for other entrepreneurs to continue their business activities or for new market entrants to commence their business activities."[18]

- Refusal to supply "necessary" products "beyond reasonable degree" where it is "difficult in reality" for the entrepreneur to produce a similar product on its own may constitute exclusionary conduct.[19]

- A substantial restraint of competition is more likely to be found where exclusionary conduct makes it "difficult" for an entrepreneur

[14] Guidelines at 5.
[15] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993).
[16] If intent will be a consideration, the Sections further recommend clarifying precisely what type or level of intent (e.g., specific or general) will be relied upon in assessing instances involving alleged EPM on the part of an entrepreneur.
[17] Guidelines at 2.
[18] Guidelines at 4.
[19] *Id.* at 26.

> "selling 'superior' products" or with "high overall business capability" to compete.[20]

The Sections respectfully suggest that the above terms in quotations may not provide sufficient guidance as drafted. For example, almost any competitively effective conduct undertaken by an entrepreneur will have the effect of "making it difficult" for another entrepreneur to compete, at least from that entrepreneur's perspective. Competition policy should not condemn a monopolist's steps that on balance benefit consumers through innovation, quality improvements, and other steps that are competition on the merits, even if they have the consequence of making life harder on rivals.

Similarly, the Guidelines could be clarified with respect to certain factors considered in determining whether there is a substantial restraint of competition. These sections are particularly important because the substantial restraint of competition requirement for private monopolization is a key element distinguishing it from unfair trade practices (which are subject to lower or no surcharges depending on the type of conduct). With respect to "Conditions of competition," the Guidelines appear to state that where robust or intensified competition exists, exclusionary conduct could be more likely to cause a substantial restraint of competition. In considering "Conditions of competitors," the Guidelines indicate that if competitors have high overall business capability *or* have insufficient supply, exclusionary conduct could be more likely to cause a substantial restraint of competition. Without further clarification or explanation, these factors are somewhat difficult to understand.[21]

E. Need for Economic Analysis and Standards

The Sections recommend that in scrutinizing public comments and revising the Guidelines, the JFTC carefully consider economic principles and relate them explicitly to the approaches taken in the Guidelines. Economic analysis attempts to understand and explain how markets behave and how competition law enforcement can best be guided in order to support the basic objectives of competition. Economic thinking and analysis have played a critical role in the development and evolution of the laws governing monopolization and exclusionary conduct in many other jurisdictions and serve as a critical tool in deciphering the complexities of modern business conduct and ensuring that the antitrust laws promote competition in the marketplace to the ultimate benefit of consumers and society.

For example, economic analysis assists in understanding rationales for conduct that might seem exclusionary; in resolving efficiencies arguments relating to such conduct; in determining the competitive dynamics of the market at issue; and in weighing the pro- and anticompetitive effects from and justifications for specific practices. Moreover, grounding competition-law enforcement policies toward exclusionary conduct in sound economic principles ensures that such policies promote competition and do not discourage practices that may appear problematic at first glance, but reveal themselves upon careful examination to be procompetitive and beneficial to consumers. Consistent reliance upon economic principles also enables antitrust law to respond to new business practices and the shifting realities of an ever-changing and increasingly-complex marketplace. In addition, such reliance promotes

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[20] *Id.* at 36.

[21] In addition, there appears to be a typographical error in the section on "degree of substitutability." The Guidelines state that where substitutability is "high," "potential competitive pressure does not tend to work, because it is not considered that users can purchase and use the entrants' products without hesitation." We presume that the drafters meant to say "low," rather than "high."

confidence in, and acceptance of, the antitrust laws by the entrepreneurs who must comply with the law and helps give businesses the clarity and objectivity they need to understand how they may function effectively and efficiently in the marketplace.

The proposed emphasis on substantial market power is but one example of how economic analysis can be related to enforcement policies concerning EPM. Firms lacking substantial market power are rarely in a position to injure consumers or impede effective competition in any meaningful sense. If a firm lacking substantial market power attempts to impose anticompetitive prices or other terms of trade on its customers, such customers can readily turn to the firm's competitors. Such behavior tends to discipline the firm's behavior, either bringing such behavior back into line with competitive norms, or causing that firm to lose market share and perhaps ultimately leave the market. Although competition law enforcement might bring about the same result, reliance on the self-adjusting tendencies of private actors in the marketplace may do so more quickly and without the costly and otherwise non-productive expenditure of taxpayer funds and investment of other resources in government enforcement efforts.

The Sections therefore urge the JFTC to state as a part of the Guidelines an intention to follow sound economic principles and to use economic analysis as a guidepost in developing enforcement policies governing exclusionary private monopolization. In addition, explaining the economic principles behind certain concepts could also improve the clarity and utility of the Guidelines.

III. Refusal to Supply and Discriminatory Treatment

A. General Comments

A number of other jurisdictions have considered whether and under what circumstances a unilateral refusal to supply may be actionable under antitrust and competition principles.[22] Such jurisdictions generally share the recognition expressed in the Guidelines that a competitor's discretion to determine whether to trade, and to determine the prices, terms and conditions upon which it will engage in trade, is at the core of the free-market system. Accordingly, the Guidelines are entirely justified in pointing out that:

> In principle, the selection of purchasers and the establishment of supply conditions independently made by an entrepreneur should be respected as [within the] discretion of the entrepreneur.[23]

Moreover, the Guidelines sound an appropriate note of caution with regard to possible application of legal sanctions to this category of conduct:

> [W]hether or not Refusal to Supply and Discriminatory Treatment falls under Exclusionary Conduct should be assessed especially prudently.[24]

The Sections support this cautionary note, and recommend that the prudential considerations suggested by this note be made more explicit.

[22] *See, e.g.*, European Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, Section IV.D. (December 3, 2008).
[23] Guidelines at 28.
[24] *Id.*

As a result of extensive experience with the application of antitrust law to unilateral refusals to supply, U.S. courts, scholars and enforcement institutions have identified several policy considerations that counsel restraint regarding law-enforcement intervention with regard to unilateral refusals to supply.[25] These include:

(1) Imposing adverse legal consequences upon a firm that engages in a unilateral refusal to supply implies a legal compulsion to supply. In other words, firms operating under legal jeopardy for declining to deal – or declining to deal on certain terms – are entitled to clear, objective and consistent guidance regarding the type of dealings that will be compelled or permitted by enforcement authorities.

(2) Competition law enforcement institutions are ordinarily not well equipped to define and enforce such compulsory terms of dealing, especially where supervision of such dealings may extend over a lengthy period of time while conditions of demand, supply and technology continue to evolve. Such ongoing administrative responsibilities require more extensive and detailed information about the functioning of the firm and the market, and more acute sensitivity to changing market conditions, than is typical of most law enforcement regimes. Supervision of this nature is said to be more appropriate for, and more characteristic of, administrative agencies tailored to the exercise of such regulatory responsibilities, which exist with regard to some industries.

(3) Where there is a legal compulsion for one competitor to deal with other competitors over time, there is an increased risk that such cooperation may weaken the independence and competitive vigor that would otherwise exist between such competitors. This risk must be balanced against the anticipated gains from compulsory dealings.

(4) Where competitors are afforded mandatory access to the superior products of another firm, there is a heightened risk that the former may lose the incentive to innovate or take initiative in order to become more effective competitors in their own right. This threat to innovation and dynamic efficiency must also be balanced against the perceived gains from challenging unilateral refusal to supply.

The Sections respectfully suggest that these policy considerations be explicitly mentioned and taken into account as reasons for special caution whenever the JFTC seeks to investigate, proceed against and/or impose remedies with regard to unilateral refusals to supply as a form of EPM. On the other hand, the Sections recognize that these policy considerations should not be treated as obstacles to well-considered enforcement efforts in specific circumstances where they can be addressed effectively. For example, although subject to a range of fair debate, it is a reasonable and widely held view in the U.S. that the legal challenge by the U.S. Justice Department Antitrust Division to certain conduct by the former Bell System – based in significant part on allegations of unilateral refusal to supply – was well-considered, and that the basic restructuring of the U.S. telecommunications industry

[25] *See, Verizon Communs. v. Trinko, LLP*, 540 U.S. 398 (2004). These considerations had been identified in previous scholarship. *See, e.g.,* Philip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L. J. 841 (1989), and Abbott B. Lipsky, Jr. & J. Gregory Sidak, *Essential Facilities*, 51 Stan. L. Rev. 1187 (1999).

that resulted from that challenge[26] has provided significant long-term benefits to competition in the U.S. telecommunications sector, and ultimately to consumers of such services.

B. Specific Comments

The Sections also offer the following specific comments on particular aspects of Part II §5 of the Guidelines:

1. The reference to "oligopolistic" markets should be deleted.

Part II §5(2)(A) ("Entire conditions of the upstream market and the downstream market"), provides the following illustration of how the JFTC will assess refusal to supply as a possible example of EPM:

> For example, where the upstream market is an oligopolistic market with a high degree of market concentration, a trading customer will not easily find another supplier who can take the place of an entrepreneur in the upstream market. The supply of products by the entrepreneur in the upstream market will therefore be more critical for the business activities of the purchasing entrepreneur. Accordingly, such a case tends to be deemed to cause difficulty to the business activities of the trading customer in the downstream market of the purchasing entrepreneur subject to refusal, etc.

This passage is subject to the interpretation that a firm in the "upstream" market that is refusing to supply a customer might be determined to be engaging in EPM by virtue of the "oligopolistic" nature of the market, or at least that the finding of EPM is made more likely by the fact that the upstream market is "oligopolistic". The Sections suggest that the reference to an "oligopolistic" market be qualified by a clear statement that substantial market power is a threshold requirement of a finding of EPM, regardless of market structure.

Accurate identification of a market as "oligopolistic" is difficult and typically subject to debate. "Oligopoly" means literally a market with few competitors. Determining when the number of competitors is limited to the point that competitive dynamics are adversely impacted is a question subject to a wide range of debate. As previously suggested, firms lacking substantial market power generally should not be subject to accusations of EPM. The Sections submit that, even within a market capable of being characterized as "oligopolistic", this principle should still apply. Suggesting that a firm's presence in an "oligopolistic" market will enhance its risk of being investigated, challenged or found liable for EPM introduces subjective elements and increases the risk for single-firm conduct that may not be justified in terms of the ultimate objectives of competition policy and sound competition law enforcement principles. The Guidelines' reference to "oligopolistic" markets may discourage vigorous but lawful competitive behavior. Accordingly, the Sections suggest that it be deleted.

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[26] It should be noted that the former Bell System consented to this restructuring; it was not imposed as a result of a contested judgment. United States v. Western Elec. Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

2. The differences in treatment between collective and unilateral conduct should be acknowledged.

In Part II §5(3), the Guidelines provide illustrative examples of the principles and considerations discussed in the preceding sections relevant to Refusal to Supply and Discriminatory Treatment. Example A. involves the refusal to license competitors by a patent pool, formed and controlled by members accounting for "almost all" of a particular product and encompassing "very important technologies", such that without a license it is "impossible" to manufacture the relevant product.

Although the appropriate treatment of the formation and subsequent conduct of patent pools is a fertile area for analysis and debate among competition scholars and enforcement officials, it should be recognized that the potential risks of collective refusals to supply are generally of a different order than for unilateral refusals. The risk to innovation, dynamic efficiency and other competition-policy values arising from the potential for erroneous application of competition law is lower when the law is enforced against a refusal to supply by an entity organized by substantially all significant competitors than when it is enforced against a single firm's unilateral refusal to supply.[27] The Sections suggest that the Guidelines incorporate some statement to this effect as a recognition of the fundamental distinction between collective and unilateral refusals to supply.

3. The JFTC may wish to compare and, if appropriate, contrast its approach in Part II §5 with U.S. "essential facilities doctrine."

The elements set out by the Guidelines to define the circumstances in which Refusal to Supply or Discriminatory Treatment[28] may exist bear a strong similarity to the elements of the "essential facilities doctrine" as defined by the lower federal courts in the U.S.[29] In order to clarify its enforcement intentions and to facilitate comparative analysis of the Commission's approach in this area with the approaches taken by other jurisdictions, the JFTC may wish to compare its approach to Refusal to Supply or Discriminatory Treatment with the essential facilities doctrine. There is an extensive literature on many aspects of the essential facilities doctrine, and this may provide a useful background for clarification of the issues.

IV. Below-Cost Pricing

A. General Comments

The Sections commend the JFTC for seeking in the Guidelines to keep "intervention in price-cutting competition … at a minimum," and encourages the JFTC, as far as possible, to specify clear zones of *legal* price competition. Vague guidelines threatening liability for prices that are "too low" can cause businesses to avoid healthy price competition beneficial to consumers. Such guidelines can thus inadvertently deter the very price

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[27] "[Refusal to supply] cases involv[ing] *concerted* action . . . present[] greater anticompetitive concerns and [are] amenable to a remedy that does not require judicial estimation of free-market forces: simply requiring that the outsider be granted nondiscriminatory admission to the club." *Verizon Comm's v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 410 n.3 (2004) (emphasis in original).

[28] Guidelines at 25-26.

[29] The doctrine has not been endorsed by the U.S. Supreme Court, but neither has it been rejected. A*T&T* v. *Iowa Utils. Bd.,* 525 U.S. 366, 428 (1999)(Breyer, J., concurring in part and dissenting in part).

competition that they were meant to preserve.[30] The Sections believe that the JFTC should provide clearer below-cost pricing guidelines to avoid this unintended effect. In particular, the Sections recommend that the JFTC more clearly define the types of “cost” at issue in its “below-cost” pricing regulations, and more clearly specify types of pricing that are *not* at risk, or at very low risk, of being found illegally “below cost.”[31] Doing so will provide a clear pricing “zone” in which businesses can vigorously compete without fear of sanction. Finally, the Sections recommend that illegal below cost pricing be limited to situations in which the seller is able to recoup its losses.

B. Specific Comments

One way to clarify the circumstances in which below-cost pricing might trigger EPM under the Antimonopoly Act is to employ presumptions – at least in the context of single-product pricing – based on whether price is below some measure of a seller’s costs. Various such thresholds have been suggested by courts and enforcement authorities. For example, one set of thresholds suggested by various U.S. courts is a sliding-scale approach that turns on the relationship of price to the seller’s average total costs (“ATC”) and average variable costs (“AVC”): (1) prices at or above ATC fall clearly outside the domain of problematic “below-cost pricing,”[32] (2) prices at or above AVC but below ATC are presumptively legitimate and (3) prices below AVC are presumptively illegitimate – with the burden of proof being on the party challenging either presumption.[33] Yet other thresholds have been suggested that turn on the relationship of price to average avoidable costs (“AAC”) and long-run average incremental cost (“LRAIC”).[34] The Sections encourage the JFTC to give further consideration to appropriate cost-based tests, because doing so will provide greater guidance to firms consistent with the objectives of sound competition policy.

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[30] *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226-27 (1993) (“[B]ecause ‘cutting prices in order to increase business often is the very essence of competition … mistaken inferences … are especially costly, because they chill the very conduct the antitrust laws are designed to protect.’… It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high” (quoting *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 122 n.17 (1986).).

[31] For example, terms such as “gross cost” and “production cost” may lack clear, broadly accepted definitions and be confusing to firms trying to conform their conduct to the law.

[32] *See, e.g.*, *McGahee v. Northern Propane Gas*, 858 F.2d 1487, 1496 (11th Cir. 1988) (recognizing “average total cost as the cost above which no inference of predatory intent can be made”); *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1346 (8th Cir. 1987) (“[A]t some point, competitors should know for certain they are pricing legally, and … this point should be average total cost” (citation omitted).); *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1056 (6th Cir. 1984) (same standard).

[33] *See, e.g.*, *Tri-State Rubbish v. Waste Mgmt.*, 998 F.2d 1073, 1080 (1st Cir. 1993) (observing that pricing below variable cost is the “normal test of predation”); *Kelco Disposal v. Browning Ferris Indus.*, 845 F.2d 404, 407 (2d Cir. 1988), *aff’d on other grounds*, 492 U.S. 257 (1989) (noting that prices below “reasonably anticipated average variable cost[] are presumed predatory”); *Henry*, 809 F.2d at 1346 (holding AVC “to be a marker of rebuttable presumptions”); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1035-36 (9th Cir. 1981) (holding that the plaintiff bears the burden of showing that prices above AVC but below ATC are “predatory,” and that the plaintiff establishes a prima facie case of predatory pricing by proving that the defendant’s prices were below AVC).

[34] Although the European Commission has noted the possibility of its using average avoidable cost (“AAC”) and long-run average incremental cost (“LRAIC”) as cost benchmarks in assessing below-cost pricing, *see Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* (Dec. 2008), neither the AAC nor the LRAIC tests have been endorsed by the European Court of Justice (“ECJ”) in the context of predatory pricing. In fact, although the Court of First Instance and the ECJ’s Advocate General contemplated a broad discretion for the Commission in selecting the economic model to apply, the ECJ’s April 2, 2009 judgment reaffirmed the applicability of the AVC and ATC tests.

The costs in question should be the seller's *own* costs, rather than the average cost of all companies in the market or some other measure of cost.[35] Regulating pricing below general average market cost, or below some other measure different from a seller's own costs, would make it extremely difficult for businesses to determine the boundaries of lawful prices, since businesses often cannot confidently measure costs other than their own, and could penalize businesses for being more efficient than their competitors.[36]

In addition to the above parameters, the JFTC should state that, to be found *liable* under the antimonopoly law for charging prices "below cost," the price-setting business must present, by its below-cost pricing, a significant threat, over the long run, to *competition* in the market where its pricing occurs – and not simply a threat to individual competitors.[37] In other words, the business must be likely to achieve or to maintain monopoly power by deterring or excluding competition with its pricing. For this reason, it should also have the reasonable prospect of being able to recoup the losses it incurred from the below-cost prices it had been charging.[38]

The below-cost pricing standards mentioned above should provide reasonably clear guidance that businesses, as well as courts and agencies, can use. For that reason, many U.S. federal courts and the U.S. enforcement agencies (in applying Sherman Act Section 2) currently employ these standards, or close variants, which are similar to those used by courts in the European Union (except as to the requirement of recoupment).[39]

The economic reasoning behind these standards supports the JFTC's goal of preserving vigorous price competition. For example, prices at or above ATC frequently allow equally or more efficient businesses to compete in the same market, and thus do not undermine competition. Recognizing that such prices will not run afoul of the below-cost pricing guidelines offers a large pricing "zone" within which businesses can vigorously compete without fear of government reprisal. *Presuming* that prices at or above AVC, but

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[35] The Guidelines provide an example in which the costs used in analyzing prices set by a local newspaper publisher included "expense items that independent entrepreneurs in general … would normally require." This can suggest that the JFTC might in some cases rely on average or "normal" costs, or at least costs other than those of the business in question. Given that using costs other than those of the business in question can confuse businesses as to how they can lawfully set prices, any exception to the use of a business's own costs should be clearly and carefully delimited. Stating that the costs used must be "deemed reasonable in the context of the actual condition" provides guidance that is too vague to inform businesses as to when costs other than their own would be used.

[36] The Sections observe that the JFTC addresses "intent" as a condition required for unlawful conduct. In the case of below-cost pricing, the Sections agree that those liable for unlawful below-cost pricing should at least intend to perform the acts at issue.

[37] The JFTC's announced goal that its guidelines should help to preserve free competition should lead it to direct the antimonopoly law toward redressing harms to competition, not individual competitors (though that law may protect them indirectly). Other laws, which have different goals, are better suited to protecting individual businesses. *See Brooke Group Ltd.*, 509 U.S. at 224 ("It is axiomatic that the antitrust laws were passed for 'the protection of *competition*, not *competitors*'" (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).).

[38] *See Brooke Group Ltd.*, 509 U.S. at 224 (requiring for liability for below-cost pricing that the defendant "had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices").

[39] *See, e.g.*, *supra* notes 32, 33, 37. *See France Telecom v. Commission* Case C202/07P. Whatever cost concepts or below-cost pricing standards the JFTC uses, it should name and clearly define the cost concepts and provide similarly clear standards for businesses to use in determining in advance if their pricing is reasonably beyond the risk of government reprisal.

not above ATC, are not problematic recognizes that the benefits of such prices do not depend on excluding competition, as they cover the costs specifically incurred to sell the products at issue. The burden of proving that these prices harm competition should thus fall squarely on those who challenge the legality of such prices. In contrast, setting prices below AVC should be deemed presumptively predatory (problematic). Such prices are typically not rational in that they would fail to cover the costs specifically incurred to sell the products at issue absent the price-setter's intention and ability to recover the resulting losses after obtaining, or maintaining, monopoly power.[40]

The reason that liability should require a likelihood of securing monopoly power is that, otherwise, the pricing in question fails to pose the threat to competition that the antimonopoly law targets. Moreover, any business liable for below-cost pricing should have been reasonably able to expect that it would likely recover the losses that its pricing would cause.[41] Otherwise, its pricing would be economically irrational and likely unsuccessful. Pricing that produces losses that a business cannot reasonably expect to recoup should also be largely self-defeating, since it harms those who do it. Low pricing by businesses that cannot succeed in achieving market or monopoly power, and low pricing that generates losses that a business cannot reasonably expect to recover, can thus be set aside as not the concern of the antimonopoly law.

The JFTC's Guidelines suggest that prices can unlawfully undermine competition if they "cause difficulty to the business activities of an equally or more efficient competitor." As noted above, the expression of causing "difficulty" to competitors is extremely vague. In a broad sense, causing difficulty to competitors – even to equally or more efficient competitors – speaks to the very nature of healthy competition, including price competition. A standard that condemns "causing difficulty" may end up undermining competition by creating incentives for firms to pull their competitive punches. We understand that the JFTC seeks to rely on various factors to help clarify the circumstances in which below-cost prices cause the "difficulty" in question. "Difficulty" is, however, a such a broad and vague concept that the Sections urge the JFTC to consider more specific and objective wording in order to achieve needed clarity for this important aspect of the antimonopoly law.

Conclusion

The Sections hope that these comments are useful. We would be pleased to respond to any questions that the JFTC may have and to offer any further assistance that may be helpful as the JFTC finalizes the Guidelines.

[40] The Sections commend the JFTC for seeking to specify in advance cases in which justifications for below-AVC pricing can exist – including below-AVC pricing of foods near spoiling. Similar guidance should also be given with respect to product promotions – which generally involve reasonable, short-term price reductions to gain needed consumer attention for promoted products, the benefits of which typically do not depend on obtaining market power. We recommend that the JFTC set forth such cases and other possible justifications as clearly as possible, while allowing for further justifications not discussed.

[41] *See Brooke Group Ltd.*, 509 U.S. at 224 (requiring for liability a "dangerous probability" of the defendant's "recouping its investment in below-cost prices").