Competition Policy Review

Draft Report (September 2014)

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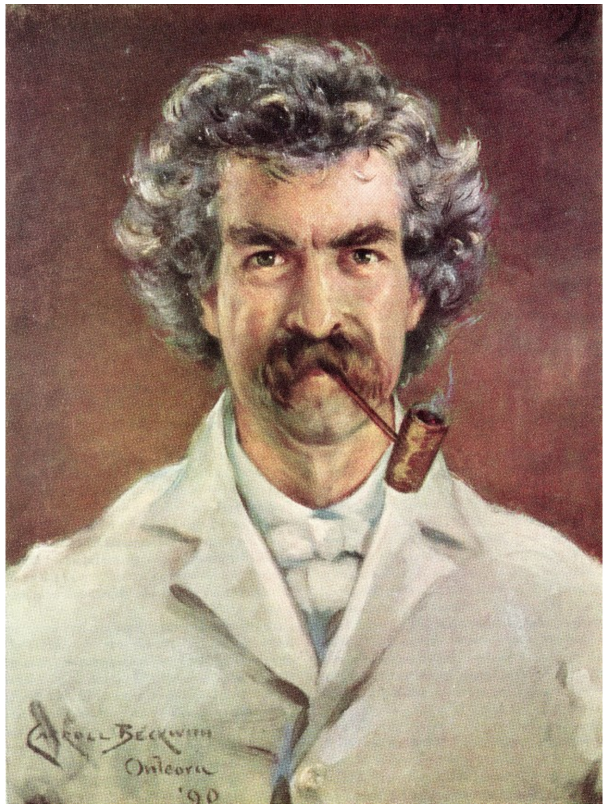

Mark Twain: “An expert is an ordinary fellow from another town.”

Many participants in the review process have been more intimately involved in the issues and the Australian cases that gave rise to the issues than I. Therefore I have no claim to “expertise” on the reform proposals. I offer the comments that follow as simply the reaction of someone who has been concerned about similar issues in another jurisdiction.

I. General Thoughts on the Ideal Structure of Antitrust Laws

Section 1 of the Sherman Act prohibits agreements in restraint of trade.

Section 2 of the Sherman Act prohibits monopolization or attempted monopolization (and conspiracy to monopolize).

Pro: This general formulation, without definitions or examples, allows courts to function effectively as common law courts in applying the statute in particular contexts. It has had the advantage of allowing courts to take into account the factual record in the cases before them in order to come to an understanding of what the terms of the statute should mean, and to evolve in accordance with economic theory.

Con: The evolutionary process is long and not always linear. (For example, it took the Supreme Court more than 100 years to work out that minimum resale price maintenance should not be illegal *per se* and 50 years to work out that maximum resale price maintenance should not be illegal *per se*. The *per se* approach to tying arrangements is likely the next to fall.)

Pro*: the emergence of the OECD and the ICN as disseminators of "best practice" is speeding up the evolutionary process considerably and serving to reduce or eliminate false starts. Therefore the flexibility to adapt to "best practices" will be extremely critical going forward.

Conclusion: It's probably too late in the game for Australia to start from scratch with such a generalized formulation. But, in my view, the less specificity the better. Over the long run, courts are likely to better at working these things out than legislators, even when guided by "experts." More importantly, courts are probably a better place for the importation of best practices on an ongoing basis, as opposed to a once-per-decade legislative review.

II. Sherman Act Section 2 v. Section 46 of the CCA[1]

A. The "attempted monopolization" extension of Section 2 does a lot of useful work. It allows the Act to reach truly anticompetitive conduct by firms currently without market power that seek to achieve it by eliminating rivals, so long as there is a "dangerous probability of success," (a court-added criterion), i.e. eventual monopolization. Therefore, at least in principle, the attempt portion of the statute can potentially reach genuine exclusionary behavior by a firm with, say, only 40% of a market (however requiring the plaintiff to show not only a dangerous probability of success – a substantial burden but not an insuperable one).

B. Section 46, requiring that the defendant be making use of substantial market power, might miss such conduct entirely, or would get at it only by a rather strained interpretation of market power such as that used by the High Court in *Boral*. Whatever one thinks of Boral's conduct, by any "normal" definition of market power, they did not have it at the time of the alleged below-cost pricing. Thus there may be a "gap" in s. 46 as compared to Section 2, but I don't think it is that large given the dangerous probability requirement of Section 2, and probably not large enough to be warrant a fundamental rewrite of s. 46. I am quite certain that *Boral* would have come out the same way under Section 2.

C. The flip side of the "dangerous probability" constraint is that the statute does not apply even to outrageous (unilateral) conduct if there is no dangerous probability of monopolization. This represents a deliberate policy choice and I would caution against any effort to allow s. 46 to "reach down" to firms with shares too small to be concerned about any risk of monopolization. The efforts of the Birdsville and similar amendments to solve the problem (as well as the "use of market power" problem, discussed below) strike me as awkward, inflexible, and confusing, to put it generously. Most tactics for "exclusion" benefit consumers and American courts have repeatedly cautioned against

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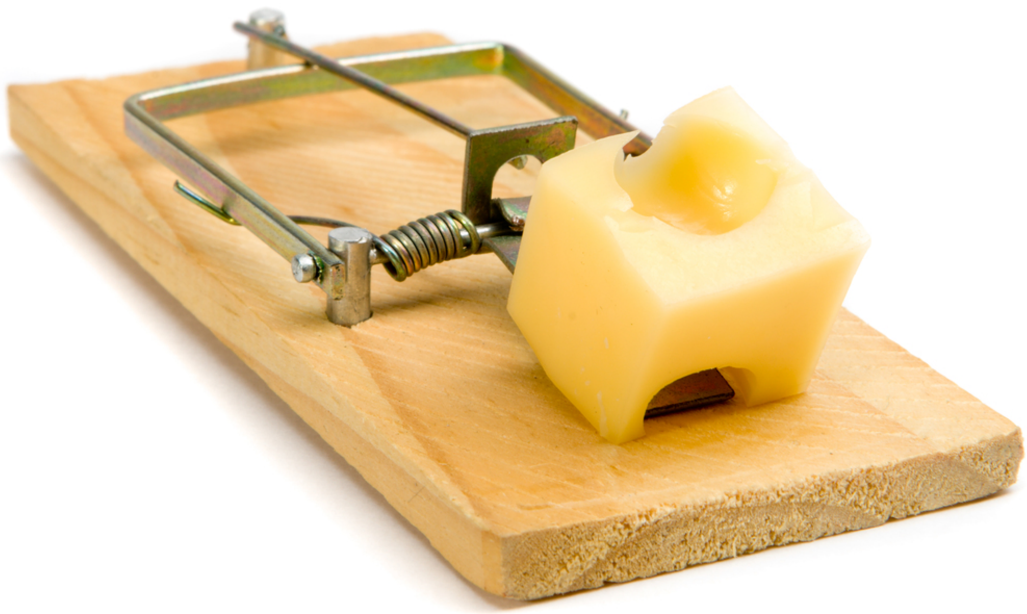
[1] Rhonda Smith and I have previously addressed this question. "'Why Can't a Woman Be More Like a Man?' American and Australian Approaches to Exclusionary Conduct,"' *Melbourne University Law Review* (December 2007).

the risk of "false positives" leading to over-deterrence. A focus on whether the defendant is "using" market power remains an exercise fraught with ambiguity at best (even for a firm with 80% of a market, is setting fire to its competitors' factories a "use of market power"?) and important gaps at worst. In the past, Australia the requirement that the defendant must be "using market power" has also played something of a prophylactic role so that bad conduct is a necessary element in the equation, though I am not convinced it always plays that role elegantly or successfully. Some familiarity with *Queensland Wire*, *Melways*, and *Boral* (among others) leads me with some concern about whether there is any consensus (much less a desirable one) on what "use of market power" really means. Moreover, I can imagine situations where the "use of market power" concept might provide a defense to conduct that one might not want to condone. I am thinking here of exclusive dealing arrangements entered into by a firm with market power to forestall the entry of competitors, when the defendant could assert that even a firm without market power might find it efficient to enter into such contracts, though perhaps not on so wide a scale. One would not want the language to preclude a court from investigating such arrangements where the overall effect may be clearly anticompetitive. Therefore I think that the reform proposed by the Review Panel which would eliminate any notion of taking advantage is definitely a step in the right direction.

D. The American language avoids another problem that infects section 46, namely the potential that s. 46 can go after a defendant whose conduct has the purpose of eliminating an individual competitor without the intent or likely effect of injuring competition more generally. As much as we might sympathize with the unfortunate victim of such "dishonorable" conduct, the early history of Section 2 suggests it is too blunt an instrument to be used to confront old-fashioned business torts. Fortunately, most of the modern industrial world had finally come to the view that the antitrust laws should be used to protect competition, not individual competitors, and the Review Panel is in good company in urging a similar resolution.

E. There is a potential (though intentional) gap in the coverage of Section 2 that should at least be mentioned and considered. Because Section 2 outlaws monopolization rather than monopoly, it focuses on how a firm achieves a monopoly position and maintains it, rather than how it uses (or abuses) it. Thus Section 2 differs in an important way from to the EU's "abuse of market dominance." There are two obvious (and related) manifestations of this "gap." First, a firm that achieves its monopoly and retains it lawfully is allowed to charge monopoly prices and earn monopoly profits for as long as it takes natural market forces to eliminate them. Second, a firm with monopoly of an input (the upstream product) that is critical to the production of another product (the downstream product) is under no obligation to sell the upstream product to a potential buyer **unless** the upstream monopolist is also participating in the downstream market and is therefore denying a competitor an essential input. (Note, however, that even if the upstream monopolist is also participating in the downstream market, it need not sell the essential input at less than the profit-maximizing monopoly price. This may effectively eliminate the "duty to deal" even where the victim is a competitor.) I believe this gap is a quite deliberate policy choice in the US scheme and I am not suggesting that it should be closed. But it does occur to me that the tag phrase "in this or any other market" that might remain in a revised s. 46 could lead to a divergence between Section 2 and s. 46 in this respect. The Policy Review team should consider whether they intend or desire such divergence.



Ralph Waldo Emerson: Build a better mousetrap and the world will beat a path to your door.

III. On Purpose and Effects Tests

The discussions of whether there should be a purpose test or an effects test or some combination have been warming if not illuminating. In part this is because there seems not to be any consensus on what those tests mean. There does seem to be widespread agreement, though not unanimity, on a few propositions:

1. A firm should not be liable simply because the purpose of its actions is to eliminate a competitor or even to eliminate competition if the underlying conduct is otherwise desirable. For example we would not wish to condemn the firm that announces its intent to build a better mousetrap in the hopes of achieving a monopoly and earning monopoly profits.
2. Similarly, a firm should not be liable for the effects of its actions on the structure of the market if the underlying conduct is otherwise desirable. Thus, we would not wish to condemn the firm that does indeed build a better mousetrap and thereby achieves a monopoly.

Is Section 2 A Purposes Test?

Certainly not! At the end of the day, Section 2 is concerned only if the conduct has an anticompetitive effect in the sense described below. But that is not to say that purpose is irrelevant. First, intent is a necessary element of the "crime," thought since Judge Hand observed in *Alcoa* that no firm monopolizes unconscious of what it is doing, proving intent has not been a special burden for plaintiffs. Evidence of intent is often highly probative as to the likely effect of a firm's conduct, though courts need to be cautioned not to be overly influenced by the x-rated documents that can be found in almost any company's files. ("Let's kill the rivals.")

Therefore, while I applaud the replacement of misuse of market power by a test that focusses on whether the conduct of a firm with substantial market power has the effect or likely effect of substantially lessening competition, I was somewhat dumbstruck that that Panel apparently plans to keep the purpose test as an alternative ("purpose *or* effect"). I need no legitimate role for a purpose test. I understand that purpose test is seen by some as the rough equivalent to the attempt provision of Section 2, but it seems to me that there is a close enough correlation between conduct by a firm with substantial market power that has the likely effect of substantially lessening competition and conduct that would satisfy the attempt provision of Section 2 that using purpose to cover the situation is unnecessary and undesirable. So if the SLC effect stays, the purpose portion should come out.

Is Section 2 an Effects Test?

If what we mean by an effects test is a test that focusses exclusively on how the structure of the market is affected by the challenged conduct, I do not think it appropriate to describe the US Section 2 as an effects test in that sense. It certainly has a structural effects element in that even horrific conduct is not caught unless it results in monopolization or a dangerous probability of monopolization. But an adverse effect on the structure of the market is not sufficient. Rather the Act looks beyond short run impacts on structure to something more general (e.g., the competitive process). Thus, for example, the court in *Microsoft* indicated:

First, to be condemned as exclusionary, a monopolist's act must have an "anticompetitive effect," That is, it must harm the competitive *process* and thereby harm consumers. … "The [Sherman Act] directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself" (citing *Spectrum Sports)*.

Certain kinds of conduct (such as "building a better mousetrap" or pricing that is low but still above cost) will be permitted regardless of any short run impact on market structure (essentially *per se* legality). Other types of conduct are neither presumptively anticompetitive nor presumptively procompetitive but must be evaluated in context. Certain exclusive dealing arrangements may have a procompetitive justification but in some contexts the anticompetitive effects will outweigh any procompetitive justification. Our courts are prepared to engage in such balancing, effectively using a rule of reason to evaluate the conduct.

Therefore, I am not sure that merely an effects test (actions are unlawful which have the effect or likely effect of reducing competition, or some version of the same theme) is adequate unless the notion of "reducing competition" has built into it the idea of injuring the competitive process rather than simply resulting in a market structure that is further from perfect competition than the *status quo ante*. That is, the statute must capable of being be interpreted in such a way that "building a better mousetrap" is not capable of being held unlawful, even if the defendant has a substantial degree of market power simply because it results in greater concentration, or even monopoly.

In the US, the safe haven for the mousetrap entrepreneur has been developed by courts in our common law fashion so that the concept of monopolization has built into it exclusionary conduct that is other than "competition on the merits."

Similarly, the evolution of US law on what constitutes predatory pricing in an example of that common law development. It now appears that pricing above cost is regarded as conduct that is presumptively procompetitive regardless of its impact on the structure of the market (although which level of cost, MC, AVC, or ATC, has not been definitively stated by the Supreme Court).

The quote from *Microsoft* suggests that it might be possible to have the "bad conduct" element of s. 46 embedded into the test of an anticompetitive effect. But I think one must be very cautious to make this clear in any legislative history. And the obvious nervousness of those concerned that an effects test will catch legitimate conduct that happens to have the consequences of making the resulting structure of the market less competitive gives me pause about whether the legislative history will be effective in curbing the ability of courts to take a more expansive view.

The Panel seems not convinced that the movement to a substantial lessening of competition as the "effect" of an effects-base test will be adequate to provide a safe harbor for "competition on the merits," and therefore introduces two defenses (or perhaps two elements of a single defense). The first simply reinstates the way the misuse test has been applied in the Australian courts ("would be a rational decision by a corporation that did not have a substantial degree of power"). As suggested earlier, my experience with this "test" leaves me uneasy that it is capable of easy and unequivocal application. Moreover it may at times have the effect of providing a safe harbor for conduct that should be condemned. It is entirely possible that there is a procompetitive justification (an efficiency rationale) for certain conduct (e.g., exclusive dealing or bundled discounts) but that, in the context of a firm with substantial market power, the anticompetitive effects outweigh the procompetitive effects (even though the same behavior would be completely innocuous, indeed, even procompetitive, for a firm with no power). It would be unfortunate if the newly introduced "defense" would provide a safe haven for such conduct.

The second defense or element of a defense ("would be likely to have the effect of advancing the long-term interests of consumers") is even more problematical because it has the effect of undermining any notion that a "substantial lessening of competition" has built into it the idea that only competition not on the merits will be condemned. Put differently, I am hard put to think of examples where conduct would (properly) be found to result in a substantial lessening of competition but still have the effect of advancing the long-term interests of consumers, unless we are to interpret the first part of the effects test as referring simply to the effect on market structure, which I would regard as unfortunate.

So what to do? The right result I think is that it should not be sufficient that conduct have the effect of making the resulting market structure less competitive (e.g., more concentrated at least temporarily). Rather the conduct itself must be conduct that one regards as anticompetitive in the sense of being other than "competition on the merits," either because of its very nature or because of the context (e.g., the exclusive dealing contracts by a dominant firm) and the burden should be the plaintiff/applicant to prove both elements. (There is an anticompetitive effect on the structure of the market and any procompetitive justifications for the conduct are outweighed by its anticompetitive effects.) I would first eliminate the purpose option altogether, leaving only the effects test. But I would make it clear either in the words of the statute or in some preamble that “substantial lessening of competition” is meant to mean conduct that is other than seeking to promote consumer welfare by delivering good products at reasonable prices, and leave it to the courts to work out what kinds of conduct could fall in the condemned category (but I say this with my fingers crossed!).

IV. Price Signaling

While I feel the pain of the ACCC in their as yet unsuccessful efforts to solve (to their satisfaction, at least) the alleged petrol station pricing problem, I think that a new version of s. 45 that focusses on price signaling is unnecessary and likely to be clumsy and/or counterproductive. Most or all of the information sharing that is likely to cause a competitive problem in an oligopolistic industry is the result of an (implicit or explicit) agreement among competitors to share information. Therefore any language that prohibits agreements that have the likely effect of substantially lessening competition ought to be adequate to solve most significant problems, although the burden lies with the plaintiff to establish the likely or actual anticompetitive effect. (The alternative approach is to treat the exchange of information as circumstantial evidence of an explicit or implicit agreement to fix prices. This is sometimes referred to as the "facilitating practices" approach where the use of facilitating practices such as information exchange is circumstantial evidence of an underlying agreement on price. See the beautifully written opinion by then circuit Judge Sotomayor in *Todd v. Exxon* for further elucidation of both modes of analysis.)[2]

The Panel seems to think that the Australian courts have given a more restrictive meaning to the concept of agreement or understanding than the American courts, and suggests adding "concerted practices." It's unfortunate that such a step may be necessary as opposed to fixing the courts' overly narrow definition. But I see no real objection to including the phrase. Of course, at the end of the day, if the problem is really what I have elsewhere called the problem of "pure oligopoly," not even Jean Tirole has come up with a fix and I assume that the phrase "concerted practices" is not intended to catch pure oligopoly or conscious parallelism, even if it results in supra-competitive prices. If that is the intent, then a whole new discussion is needed.

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[2] The Report references two U.S. cases on facilitating practices. I caution the Panel about these references. The first, *Du Pont*, was a case brought by the FTC under Section 5 of the FTC Act which outlaws unfair business practices (and is generally believed to include, at a minimum, any conduct that would violate Section 1 or Section 2 of the Sherman Act. However, the FTC complaint clearly was intended to go beyond Section 1 since the complaint made no use of the word "agreement," either an agreement to engage in certain practices, including public price announcements, or an underlying agreement on price. Rather, the FTC's theory was that mere parallel use of certain facilitating practices could violate Section 5 if it leads to supra-competitive pricing. But more critically for the Panel, the Court of Appeals soundly rejected the FTC's approach. In the second case, *Petroleum Products*, the analytic discussion of facilitating practices in the 9th Circuit opinion is very sensible but it is generally regarded as *dicta*, as the outcome did not turn on the use of facilitating practices. A number of Americans, including me, have written about the law's use of the facilitating practices concept and any one of those references might make for a more useful citation, The bottom line is that no court I am aware of has determined that the use of facilitating practices, without prior agreement, constitutes an unlawful act (as opposed to being evidence of an underlying unlawful agreement).

V: Vertical Agreements, Full Line Forcing and the Rest

In my opinion, the *per se* rule should be reserved for horizontal agreements. However, there seem to be strong feelings about relaxing the *per se* rule for RPM. I would not jeopardize the reform proposals by insisting on relaxing the rule for RPM. At some point, there will be harmonization on this point in one direction or the other, but it's not that big a deal.

VI: Divestiture

The Panel proposes to leave divestiture out of the statute as a possible remedy. This seems mistaken to me. In the US, divestiture has rarely been used, but there will be times when it is the only remedy that will work without excessive supervision by courts (e.g., mandating that a monopolist charge a competitive price). I am thinking of a situation where a dominant firm has succeeded in elimination all meaningful competition before a court can act. In AT&T, the dissolution of the nationwide monopoly had a profoundly procompetitive impact and it is hard to imagine any other remedy that would have been nearly as effective. The same is likely true for the 1911 breakup of the Standard Oil empire. And in the landmark *Alcoa* case, the remedy of requiring Alcoa to divest itself of its Canadian subsidiary, Alcan, was a relatively easy way to create a new competitor in the US market.

VII. Economic Evidence and the Courts

One topic discussed only in passing in the Draft Report was the use by courts of economic evidence. This was perhaps not in the jurisdiction of the Review Panel and is best left for another day (and another speech). Let me say simply that, in my admittedly limited experience, the attitude of the Australian courts towards economists and economic evidence seems to be significantly non- uniform. In the US we are used to the idea of economists assisting the court by digging up evidence ourselves (e.g., an econometric analysis of prices) or pointing the court to evidence that we think ought to affect the court's decision-making process. We would have no objection to an economist saying something like: "My opinion is that the market should be defined as __, based on the following evidence (including both the facts and the analysis of those facts." Some Australian judges seem to want the economist to do nothing more than to state bare-bones statements of economic theory, unconnected to the case. Others are willing to allow economist to perform analysis and reach specific conclusions so long as the economist states clearly the factual assumptions on which the analysis is based (which is a thinly disguised way of pointing the judge to facts the economist thinks are vital). I am sure there are other approaches as well. We would do well to recall the many sensible things Maureen Brunt had to say about the use of economic evidence and ponder how to implement that message in actual practice. Whatever the decision is, it should be applied uniformly.