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Prospects for Convergence in the U.S. and the EC Approach to Dominant Single Firms

Janet L. McDavid and Jean-Michel Coumes*

On September 8, 2008, the United States Department of Justice ("DOJ") issued its report on monopolization under the U.S. antitrust laws—"Competition and Monopoly: Single-firm Conduct Under Section Two of the Sherman Act" ("DOJ Report").[1] The Report was based largely on joint hearings undertaken by DOJ and the Federal Trade Commission ("FTC") (collectively "the agencies") from June 2006 to May 2007 with the aim of exploring treatment of single-firm conduct under the U.S. antitrust laws. Numerous practitioners, economists, and enforcers participated in these hearings.

It was generally expected that the agencies would issue a joint report, but it is now clear that the agencies' views diverged, both practically and substantively. The DOJ Report sets out DOJ's current Section 2 enforcement policy both generally and as it relates to certain specific conduct, including predatory pricing, predatory bidding, loyalty discounts, tying, bundling, and exclusive dealing. At least three FTC Commissioners believe that the DOJ Report is a "blueprint for radically weakened enforcement of

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[1] U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 129 (2008) [hereinafter DOJ Report].

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Section 2 of the Sherman Act."[2] These Commissioners criticized the DOJ Report, saying that they expected,

> a Report that would identify outstanding issues in Section 2 enforcement; provide neutral and balanced illustrations of the conflicting positions that have been taken on these issues; and suggest topics for further study to resolve the debate.

FTC Chairman Kovacic also seems to have envisioned a different end product, specifically,

> a DOJ/FTC report on the unilateral conduct deliberations [which] would devote considerable effort to put modern developments in context—to examine how the U.S. antitrust system developed as it did, and to assess what that history means for the future of U.S. and global competition policy.[3]

However, Chairman Kovacic stopped short of criticizing DOJ's Report.

Underlying the recommendations in the DOJ Report is the premise that the desire to obtain monopoly profits drives firms to innovate and compete and that this conduct benefits consumers. DOJ is primarily concerned that over-deterrence will chill this behavior, i.e., that the heavy hand of enforcement will needlessly deter aggressive competition and innovation, and ultimately disadvantage consumers. It is less concerned about effects of under-enforcement. As a consequence, the DOJ Report signals that its current enforcement approach would only impose liability under Section 2 of the Sherman Act under standards that offer wider latitude for aggressive conduct by monopoly firms than prior enforcement standards would have countenanced. For

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[2] *Statement of Commissioners Harbour, Leibowitz and Rouch on the Issuance of the Section 2 Report by the Department of Justice*, September 8, 2008, available at: http://www.ftc.gov/os/2008/09/080908section2stmt.pdf. [hereinafter Commissioners' Statement].

[3] *Statement of Federal Trade Commission Chairman William E. Kovacic, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act*, September 8, 2008, available at http://www.ftc. gov/os/2008/09/080908section2stmtkovacic.pdf.

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example, in the absence of a conduct-specific test (such as for predatory pricing), DOJ proposes that conduct be considered anticompetitive only when it results in harm to competition that is "disproportionate" to any consumer and economic benefit.[4] In other words, the anticompetitive harm of the conduct must substantially outweigh its likely benefits in order for liability to attach.[5] As DOJ recognizes, this is a high burden for both plaintiffs and government enforcement agencies to meet, a burden that is too high according to three Commissioners.[6] These differences are also reflected in the agencies' enforcement records in recent years: DOJ has not filed a Section 2 case during the Bush Administration, while the FTC has brought several cases.

How the DOJ Report will play out remains to be seen, particularly in light of the FTC's disagreement with much of the Report and the coming change in administrations. At minimum, the DOJ Report will provoke useful discussion regarding antitrust enforcement policy related to single-firm conduct. A particularly interesting part of that discussion will involve a comparison between U.S. and EC policy. This comparison is particularly timely since the European Commission also is moving toward a reform of its policy in relation to single-firm conduct (embodied in Article 82 of the EC Treaty, which is the equivalent of Section 2 of the Sherman Act).

The United States and European Commission are generally believed to have different standards for evaluating dominant firm conduct under the competition laws. In

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[4] DOJ Report at 45.

[5] *Id*.

[6] "At almost every turn, the Department would place a thumb on the scales in favor of firms with monopoly or near-monopoly power and against other equally significant stakeholders." Commissioners' Statement at 1.

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the United States, liability under Section 2 of the Sherman Act is heavily dependent upon the effect of the suspect conduct, i.e., whether the conduct at issue caused actual competitive harm and, if so, how that harm compares to any pro-competitive benefits that may have resulted. As a consequence, economics plays a significant role in the analysis, as does the business justification for the behavior. The EC policy of single-firm conduct enforcement traditionally has been considered to be more formal and less grounded in economics. It has been criticized for classifying certain conduct by single-firms as per se infringements of EC competition law regardless of the technical or economic efficiencies that such conduct could have. Concerns also have been expressed that the European approach protected competitors rather than consumers, thereby applying a test that could chill innovation and growth in the long term.

In December 2005, the European Commission published a Discussion Paper proposing reform of its approach to single-firm conduct to address some of these criticisms.[7] The Paper clarified that the principal concern of enforcement policy directed at single-firm conduct should be consumer welfare and not protection of competitors. The Paper also suggested the possibility that dominant firms could assert an efficiency defense. Although the change of approach was generally welcomed by the bar and business community, the Commission has never finalized its views. In a recent speech, Competition Commissioner Neelie Kroes nevertheless confirmed that a reform of single-

[7] *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, 19 December 2005.

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firm conduct was still on the Commission's agenda and that her team was working on a revised paper on single-firm conduct based on the 2005 paper.[8]

All of these elements—in addition to the very recent market disruptions in both the United States and the European Union—create considerable uncertainty about future prospects for convergence of policy on unilateral conduct in the two jurisdictions. The DOJ Report, for example, might suggest that a gap will persist, but it is by no means certain that the Report will have a long term effect on U.S. enforcement policy, especially given the coming change in administrations. On the other hand, if the EC were to adopt the core principles in the 2005 Discussion Paper, that might suggest a greater convergence, but it is by no means certain that the European Community will embrace these principles. It also is possible that there will be greater convergence between the European Commission and either DOJ or FTC than there is between the U.S. agencies. Lawyers and businesses on both sides of the Atlantic will have to take account of this fundamental uncertainty, and will likely emphasize antitrust risk avoidance.

I. SIMILARITIES BETWEEN THE U.S. APPROACH AND THE EC "NEW" APPROACH

Some of the themes in the "new" EC approach to single-firm conduct should move the EC position closer to United States. It is an open question, however, how the DOJ Report will affect potential convergence with Europe.

A. The EC may focus on a less formal, and more effects-based approach.

[8] *Exclusionary abuses of dominance— the European Commission's enforcement priorities,* Fordham University Symposium, New York (Sept. 25, 2008).

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With the exception of a very few types of conduct considered per se illegal under the U.S. antitrust laws—price fixing, boycotts, and market allocation agreements—liability under the U.S. antitrust law is effects driven. The DOJ Report is unlikely to change this and, as outlined in the Discussion Paper and reiterated in Commissioner Kroes' speech, the European Commission probably will move toward a similar effects-based analysis. Recognition of an effects-based approach in the EC would place less reliance on per se rules and non-rebuttable presumptions of market foreclosure and focus more on (i) whether consumers are likely to be worse off as a consequence of the dominant company's conduct and (ii) whether there are competitive constraints sufficient to constrain the conduct of the dominant firm. Ironically, however, just as the EC is moving closer to the U.S. position, the DOJ Report raises the possibility of a U.S. enforcement policy for single-firm conduct (at least at DOJ) that focuses less on enforcement and more on protecting the ability of dominant companies to compete aggressively on the theory that a lighter regulatory hand ultimately will benefit consumers in the long-run.

B. More reliable cost benchmarking.

Another similarity in the evolution of EC and U.S. policies on single-firm conduct seems to be the desire to provide the business community with more legal certainty by proposing some predictable benchmarks for certain types of conduct such as price predation and bundling. The idea is that benchmarks should make it easier for companies to know whether certain behavior is in the danger zone. This is an area in which the DOJ

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Report expended significant effort, exploring a number of tests in order to determine the most appropriate measure of costs. Ultimately, the DOJ arrived at the conclusion that average avoidable costs is the appropriate test for both predatory pricing and bundling, a conclusion with which the EC appears to agree. In its Discussion Paper in 2005, the Commission also proposed to use average avoidable costs instead of average variable costs to evaluate predatory pricing claims.

Another similarity may be use of the "equally efficient competitor" test. In her speech, Commissioner Kroes suggested that the Commission would be increasingly relying on the "as efficient competitor" test. The DOJ Report states that the DOJ also finds this test useful and notes that it may be suited to certain pricing practices.[9] However, the two jurisdictions may diverge on the level of importance that should be given to this test. Specifically, the DOJ Report finds the test as a whole not readily applicable to certain types of conduct, such as tying or exclusive dealing.[10]

C. Recognition of efficiencies.

Over the past 10 years, efficiencies achievable by a monopolist through potentially anticompetitive practices have played an increasingly important role in U.S. antitrust analysis, a role that the DOJ Report considers critical in Section 2 analysis. For example, the disproportionality test proposed by the DOJ Report emphasizes efficiencies, requiring plaintiffs to show either the absence of pro-competitive benefits or that the anticompetitive effects of the conduct at issue disproportionately outweigh the pro-competitive effects. This emphasis on efficiencies from the point of view of the

[9] DOJ Report at 43.

[10] *Id.*

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monopolist tends to downplay the significance of consumer harm or harm to the competitive process, both of which have been traditionally touchstones of Section 2 jurisprudence. Commissioner Kroes has seemed to be open to the availability of an efficiency defense for single-firm conduct, although whether the importance of efficiencies in the EC analysis ever rises to the level suggested by the DOJ Report is an open question. Nevertheless, conduct that generates efficiencies should not, in the "new" EC approach, be deemed abusive unless it is demonstrated that the impact of the conduct on competition will result in consumer harm that outweighs these efficiencies.

II. DIFFERENCES MAY CONTINUE

A comparison between the DOJ Report and the European Commission's position (as expressed in the Discussion Paper and in Commissioner Kroes' speech) outlines a fundamental difference of approach in the evaluation of single-firm conduct. Whereas DOJ is primarily concerned about risks of over-enforcement and its potential to discourage efficient conduct by monopolists, the Commission (like the three FTC Commissioners) seems focused on risks of under-enforcement. Specifically, the DOJ Report's suggestion that the test for liability should be whether the harm is disproportionate to benefits obviously narrows the scope of Section 2 liability because it puts a heavier burden on both public prosecutors and private plaintiffs in actions against dominant firms, and may under-emphasize the long-term harm to consumer welfare that could result from dominant-firm conduct that undermines the competitive process. In contrast, the Commission believes that conduct "potentially" harmful to competition

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should be investigated. Commissioner Kroes has stated that this difference may stem in part from divergences in private enforcement systems, and as FTC Chairman Kovacic noted, the U.S. policy that authorizes treble damages for successful claimants in private antitrust actions, coupled with the use of jury trials, has created an environment in which U.S. courts are increasingly hostile to antitrust liability. In contrast, private enforcement in competition cases is not well-established in the EC, and it is unlikely that EC litigation would mirror the U.S.-style approach.

Therefore, the business community should not take it for granted that the European Commission's new approach will result in more limited enforcement of Article 82. In the U.S., in light of the divergence between the FTC and the DOJ, it is unclear what industry should take from the DOJ Report. Clearly, the DOJ has set a high hurdle for Section 2 enforcement. However, the FTC "will continue to be vigilant in investigating and, where necessary, prosecuting Section 2 violations."[11] Divergence between DOJ and the FTC may mean that the likelihood of being investigated or challenged depends on which U.S. agency has jurisdiction—a highly undesirable outcome from a policy perspective.

It is also likely that there will be continued divergence in the application of the efficiency defense on both sides of the Atlantic, particularly under the position advocated in the DOJ Report. By requiring plaintiffs to prove that harms from restrictions of competition significantly outweigh benefits, DOJ would effectively establish a rebuttable presumption that single-firm conduct generally is beneficial to consumers. Even if the

[11] Commissioners' Statement at 11.

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DOJ Report has limited effects on overall enforcement of Section 2, the U.S. may continue to be more hospitable to efficiency claims than the European Commission.

The European Commission is likely to introduce a much more narrow efficiency defense than the DOJ Report. It will likely place a significant burden on the dominant company to prove that any efficiencies significantly outweigh the harm to competition. Dominant companies are likely to have to prove that their conduct was indispensable in order to achieve efficiencies and that workable competition was not eliminated. As a result, in the EC, liability could be imposed even on conduct that gives rise to significant efficiencies because there exists a less restrictive alternative.

Finally, whereas the DOJ Report clearly distinguishes between the interest of competitors' and consumers, and sometimes views them as inconsistent, the Commission seems unlikely to draw such a clear distinction between the two, despite previous comments that it would focus on consumers. In addition, Commissioner Kroes' recent speech echoed previous comments in the Discussion Paper that consumer harm starts when there is a "likelihood of anticompetitive foreclosure."[12] Since in practice any reduction in the number of competitors may lead to some anticompetitive effects, this statement does not give clear guidance on how the Commission intends to draw the line between protection of consumers and competitors. If consumer welfare supposes no reduction in the number of competitors irrespective of these competitors' efficiency, the new approach may involve no major practical changes compared to the old one.

[12] Kroes speech, note 9 *supra*.

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At the end of the day, the DOJ Report is a thoughtful, provocative contribution to Section 2 scholarship, but of questionable long-term effect given the current divergence with the FTC, the likely continued differences with Europe, and the coming change in administration. As a result, counselors are unlikely to rely on it in advising clients with dominant positions on the risks attached to certain conduct. Nonetheless, the Justice Department has certainly enlivened the discussion about single-firm conduct.

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