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LETTER FROM THE EDITOR

Dear Readers,

This summer, the August 2020 Antipasto edition of the Chronicle features articles from members of the CPI Editorial Advisory Board.

This compilation of articles covers a variety of jurisdictions and a diversity of antitrust topics including the regulation of multisided platforms, the acquisition of foreign-subsidized companies and merger information requests in the EU, and the treatment of non-compete clauses and hub-and spoke infringements in China, among others.

We are pleased to kick off this CPI Antitrust Antipasto edition with a CPI Talks… interview with Mr. Ian Conner of the U.S. Federal Trade Commission.

Looking forward, our August and September Chronicles will feature contributions from U.S. State AGs, and discussions of the failing firm defense, and price gouging.

Lastly, please take the opportunity to visit the CPI website and listen to our selection of Chronicle articles in audio form from such esteemed authors as Maureen Ohlhausen, Herbert Hovenkamp, Richard Gilbert, Nicholas Banasevic, Randal Picker, Giorgio Monti, Alison Jones, and William Kovacic among others. This is a convenient way for our readers to keep up with our recent and past articles on the go, at home, or at the beach.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

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CPI Talks…

…with Ian Conner

In this month's edition of CPI Talks… we have the pleasure of speaking with Mr. Ian Conner, Director of the Bureau of Competition at the U.S. Federal Trade Commission.

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Some Observations on Claims That Rising Market Power Is Responsible for U.S. Economy Ills and That Lax Antitrust Is the Villain

By Dennis W. Carlton

This paper evaluates the recent literature claiming that the U.S. economy has generally become less competitive causing the U.S. economy to perform poorly and that lax antitrust policy is one important reason for the decline in economic performance. Although there certainly are empirical facts requiring further study, I conclude that the evidence does not support calls for dramatic changes in antitrust policy.

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Regulating Multisided Platforms? The Case Against Treating Platforms As Utilities

By Rosa M. Abrantes-Metz & Albert D. Metz

The bloom is off the Big Tech rose. It seems nearly the entire political spectrum is angry with Amazon, Google, and Facebook for one reason or another. This has led to a great deal of discussion on whether and how to regulate (or even break up) these platforms, including whether they should be regulated as utilities. Our purpose with this article is simply to caution against some forms of regulatory treatment which emphasize the utility-like nature of large platforms. We choose the word "caution" because we are not necessarily arguing that such regulation is in all instances inappropriate or uncalled for. Instead, all we mean is that there are counterarguments which should be considered, and in this article, we give voice to some of those arguments. The basic economic argument for utility-like regulation of internet platforms is that these platforms can become "natural monopolies" which tend to forestall competition. While there is merit to this argument, internet platforms have also been a source of tremendous innovation which in turn has allowed entrants to unseat what were once thought to be entrenched incumbents. Regulation risks quashing such innovation and harming consumer welfare.

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The New Tentacle of EU Competition Law: Tools to Control Foreign-Subsidised Acquisitions and Market Distortions

By James Killick, Giuseppe Tantulli & Aron Senoner

We live in a world where the boundaries of antitrust seem to be ever expanding. Antitrust is both a sponge, absorbing up new ideas from other domains, and a jellyfish – growing new tentacles. This article looks at the European Commission's proposal for new powers to control foreign-subsidized acquisitions and market distortions. It concludes by looking at the risk of antitrust losing its coherence and that its core principles may become diluted.

SUMMARIES

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If It Ain't Working, Fix It — With Competition, Not Monopoly

By Jay L. Himes & Jonathan S. Crevier

The ability of individuals to repair, maintain, or modify things they own is often referred to as the "right to repair." In recent years, manufacturers have erected barriers, "repair monopolies" that require customers to have items repaired exclusively by the manufacturer or its authorized agent. These repair monopolies dilute customer ownership. Manufacturers assert that items customers believe they have purchased were "licensed." Insofar as the "license" view prevails, "owners" may be barred from doing what they want with their devices. Customers pay more for repairs than they otherwise would have, and environmental waste results. Moreover, amidst of the COVID-19 pandemic, repair monopolies have disabled hospitals from fixing broken devices used in treatment, thus demonstrating that protecting the right to repair has critical human health implications. Antitrust laws can — and should — be used to challenge repair monopolies.

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Requests for Information in Merger Cases: Regulatory Overreach?

By Jakob Dewispelaere

In addition to a long and extensive Form CO, the European Commission collects further information and data via requests for information. Focusing on the request for internal company documents, this article considers whether the Commission overextends its powers and whether the merging parties' rights of defense are guaranteed. It discusses key issues such as (i) the Commission's broad discretion and the limited possibility for merging parties who wish to proceed swiftly to moderate or challenge the case team's RFIs; (ii) the scope of the internal document request; (iii) the inadequate protection of LPP; (iv) the recurrent decisions to stop the clock and the link with the internal document RFI; and (v) the case team's use of the internal documents as evidence.

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China: Non-Compete Clauses in the Transactional Context

By Adrian Emch

Non-compete clauses in agreements between competitors can be problematic under antitrust rules. China is no exception. A sub-set of non-compete arrangements between competitors – those entered into within the context of a structural transaction – has received very little attention by legislators and regulators in China. There is a lack of explicit rules as to whether and how non-compete obligations can be justified in the transactional context. Against this background, this paper attempts to analyze non-compete clauses under the general antitrust framework and looks at four judgments by Chinese courts from 2019 and 2020.

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New Wine Into New Wineskins: Analyzing Hub-and-Spoke Antitrust Cases in China

By John Jiong Gong, Vanessa Yanhua Zhang & Rita Li

In 2020, the Anti-Monopoly Law of China is under revision and the draft amendments have introduced a separate clause to deal with hub-and-spoke antitrust cases. In this article, we visit the hub-and-spoke conspiracy from the perspective of economists. First, we set the hub-and-spoke conspiracy into three categories and explain their characteristics. Second, we review and compare two representative hub-and-spoke cases, one is administrative investigation and the other is litigation case. Via these two cases we illustrate the two different approaches that competition agencies and the court have taken, per se illegal versus rule of reason. Finally, we lay out the economic analysis framework for approaching hub-and-spoke cases and intend to shed some light on the core issues that one should investigate when dealing with such cases in China.

WHAT'S NEXT?

For September 2020, we will feature Chronicles focused on issues related to (1) **Price-Gouging**; and (2) **Failing Firm Defense**.

ANNOUNCEMENTS

CPI wants to hear from our subscribers. In 2020, we will be reaching out to members of our community for your feedback and ideas. Let us know what you want (or don't want) to see, at: antitrustchronicle@competitionpolicyinternational.com.

CPI ANTITRUST CHRONICLES OCTOBER 2020

For October 2020, we will feature Chronicles focused on issues related to (1) **CRESSE Insights**; and (2) **Collaboration Agreements**.

Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.

CPI TALKS…

…with Ian Conner

In this month's edition of CPI Talks… we have the pleasure of speaking with Mr. Ian Conner, Director of the Bureau of Competition at the U.S. Federal Trade Commission ("FTC").

Thank you, Mr. Conner, for sharing your time for this interview with CPI.

1. The economy continues to recover from the effects of the COVID-19 pandemic. How has the FTC responded to the crisis? Have patterns of conduct, merger activity, and enforcement been significantly impacted by the new economic conditions?

The Bureau and our colleagues throughout the Commission have responded to the changes brought on by the pandemic amazingly well, given the significant challenges that this process has entailed both in the Bureau's work and in the personal lives of our colleagues. A prime example is the HSR program. As soon as we learned that we would be moving to full-time telework, the staff of our Premerger Notification Office rallied to the task of setting up –for the first time ever – an electronic filing system for HSR Notifications. The PNO announced the plan on Friday, March 13th, and it was operational by Tuesday, the 17th. It has been a tremendous success. Staff has been able to process and review HSR filings remotely without disruption.

Not surprisingly, HSR filings have dropped significantly since March. If you compare recent activity to the levels for prior months and years from our annual HSR reports, you can see that there has been a significant drop in filings year-over-year. (Due to increased interest in M&A activity during this time, the Bureau started publishing monthly HSR figures in July. They are on the PNO webpage.) But fewer filings does not necessarily mean less work. We are seeing a higher number of non-reportable deals being flagged to us for potential competition concerns, especially in health care, and we also are seeing a higher percentage of HSR filings that trigger investigations and second requests.

What might be surprising to some is that there has not been a slowdown in merger enforcement. Despite the challenges of working during the pandemic, we continue to operate at an extremely high level of activity, even in comparison to periods before the pandemic. In just the four-month period since we transitioned to mandatory telework, the Commission has challenged one merger, *Altria/Juul*, and required divestitures in six others. Another five mergers have been abandoned while under investigation. We also announced a settlement with Indivior over product hopping, which included $10 million in consumer redress, and settled an order violation investigation of Alimentation Couche Tard, which included a civil penalty of $3.5 million for its failure to divest on time, maintain the divestiture assets and accurately report on its divestitures. We also released the final Vertical Merger Guidelines. All of this new work is in addition to significant investigations and litigations that predate the pandemic period that continue on: we have four matters in active federal court litigation, and those litigation teams, as well as others throughout the Bureau, have pivoted to using technology to participate in hearings and conduct depositions and investigational hearings remotely.

I think our biggest challenge is that many in the Bureau are dealing with personal demands on their time due to changes in childcare or elder care, as well as adjusting to the more mundane changes to many parts of our daily lives. No one misses the commute, but I know we all miss the collegiality and support that we get from seeing one another while working together. The Bureau is staffed by incredibly dedicated public servants and now more than ever those of us in management are trying to ensure that they are able to balance their work and personal demands under these very challenging circumstances.

2. In May 2020, you drew attention to the issue of the "failing firm" defense, noting that it "has been striking to see firms that were condemned as failing rise like a phoenix from the ashes once the proposed transaction was abandoned." Have invocations of the failing firm defense been more prevalent during the pandemic? How has the agency approached this issue in recent cases?

I would say what we are seeing more often are failing firm-esque arguments. Multiple parties have said that they "aren't making a failing firm argument, but . . ." The failing firm is a defense that has been recognized by courts and even litigated to decision. At its core, the defense is just that — it can be employed to absolve an anticompetitive merger. But the defense has specific elements, and if you don't meet those elements, your merger is illegal. We do not reject a failing firm defense out of hand, and it is part of our analysis under the Horizontal Merger Guidelines. Yet even under current conditions, you will be required to show how you have met each of those requirements.

What I am most concerned about is that while many companies face what are hopefully temporary challenges, permitting an anticompetitive merger to proceed will have lasting ramifications long after the present COVID pandemic. The competition that is lost will not come back, even once the economy does. We need to be sure that in permitting such a transaction to go through, it is the best alternative to having the acquired company go out of business and its assets exit the market. That means that bankruptcy reorganization is not an option and there are no less anticompetitive bidders. The fact that one or both companies aren't doing as much business right now or have seen profits fall since March is far from adequate to be deemed failing or to justify the harm customers will face due to an anticompetitive merger.

3. Antitrust enforcement in the tech sector continues to make the headlines. Throughout 2019 and 2020, agencies around the world (notably in the EU, Germany, Australia, and the UK) have commissioned reports and proposed new laws to bolster enforcement in the "digital economy." What is your view on the state of antitrust enforcement in tech? Are new rules needed in the U.S. or elsewhere?

While the technology sector poses several challenges for antitrust enforcement, I think existing laws are flexible enough to tackle these challenges. To marshal our scarce resources to meet these challenges, in February 2019, the Bureau announced the creation of the Technology Task Force, which has since become a permanent Division of the Bureau, the Technology Enforcement Division. The Division is meant to develop a deep understanding of the business models, practices and emerging technology used by participants in this important segment of the economy, with a view to promoting and protecting competition.

I would note that while much of the general debate is focused on just a few large tech platforms, there are many tech sector companies throughout the economy. The Commission's pending case involving a multisided e-prescription platform is one example. In April 2019, the Commission voted to challenge the anticompetitive practices of Surescripts in federal court; the matter is presently in discovery.

In fact, there is a lot of variety in the business models used by technology platforms. Even though the GAFAM companies are often grouped together in antitrust discussion, each of these companies is quite different. They operate in very different markets and provide different services. Some provide a free service that is funded through advertising while others provide services and sell products using commission-based pricing while also selling their own products. And then there are aspects of the tech companies that combine these business models. Each platform presents different questions about how they operate their business, what agreements they have with their suppliers, sellers, and users, and how to calculate prices when products are free, including initial sunk costs such as hardware or subscriptions. Remember that the FTC is a law enforcement agency and not a regulator and so our focus is on enforcing the laws to prevent anticompetitive conduct. In order reach any conclusions about a particular company or industry sector, an antitrust enforcer has to go through a fact-intensive analysis that is unique to each case.

4. Following the FTC's own hearings (in 2018) and the recent and upcoming Congressional hearings into the technology sector, what actions can be expected by the agencies in this sector? Is the FTC planning to modify its enforcement practice in the near to medium term?

I highly recommend watching the archived videos of some of the panels, where we gathered experts to discuss and debate thorny issues of antitrust law. I think the hearings highlighted that there is great complexity and varied views on the technology sector and antitrust laws' ability to tackle that complexity. But, most importantly, the Hearings indicated that there was a need to expand our expertise in this area. That is what we are doing through the work of the Technology Enforcement Division and through the Commission's 6(b) study of acquisitions by the largest companies in the technology sector.

While I cannot speculate as to what actions may be taken by the Commission in any particular matter or following the study, it is clear that all of these efforts taken together help advance our understanding of the practices of the platforms and the rationales behind acquisitions.

Where our investigations produce evidence that companies have engaged in practices or acquisitions that are anticompetitive, we will bring recommendations for enforcement to the Commission.

I think the Commission has a good track record of vigorous enforcement and getting things right. But we're not infallible. Sometimes our predictions about the likely effects of a merger or the remedies we impose may not pan out, and sometimes courts disagree with our predictions and decline to block a merger. That's why periodic look-backs and broad public conversations are essential to recalibrating our approach and our expectations of what we can achieve through antitrust enforcement. The Hearings have been invaluable in that regard, and we are now in that period of self-reflection that will help determine if there are areas in need of additional attention in our enforcement or changes necessary to the law.

5. Specifically, concerning merger review in technology, the FTC's probe into Facebook, (including its Instagram acquisition), raises the possibility of unwinding historical deals if they are found to be anti-competitive. Are such transactions a particular risk in the tech sector? What should be the thresholds for agencies to contemplate such a remedy?

I gave a speech earlier this year on our remedies toolbox. For consummated mergers, our first tool is always unwinding the transaction to restore the level of competition that existed prior to the acquisition. I don't think that this option is any more or less preferred in the technology sector. Being able to accomplish an unwinding may be more challenging in the technology sector given the speed of technology developments and the presence of network effects, but the perfect cannot be the enemy of the good. Even if we think a full structural remedy is not workable, we can look to other tools in our toolbox to restore competition as best we are able. The fact that an anticompetitive transaction is consummated and a remedy is complicated should not stop us from counteracting the harmful effects.

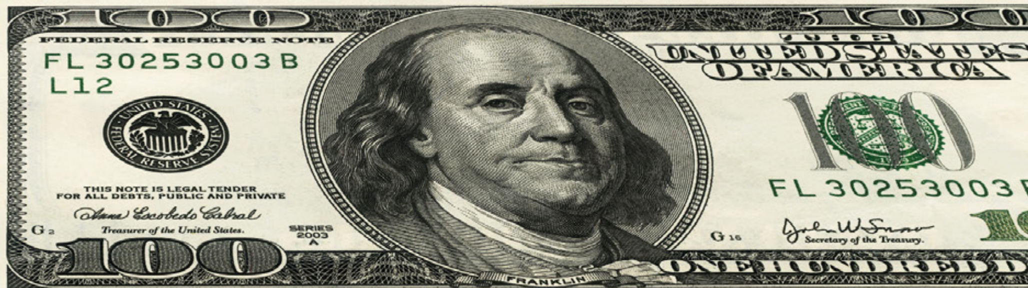
6. In June, the FTC and the DOJ issued new Vertical Merger Guidelines. What are the most significant changes to the guidelines? Do the guidelines usher in a new approach to enforcement, or do they reflect a codification of existing practice? Do you agree, as some authors have suggested, that merger review in the U.S. is in need of "revitalization"?

The Vertical Merger Guidelines are not intended to signal a change in policy from existing practice, but instead meant to codify our present enforcement approach. Unlike the 1984 Guidelines, the new Guidelines clarify that the agencies consider a full range of possible harms from vertical transactions, and provide a non-exhaustive set of examples. Raising rivals' costs, foreclosure, and concerns around diagonal or vertical complements are not new theories of harm, but they have not been set out in a guidance document before now. The most important insights in the Guidelines relate to expanded guidance regarding unilateral effects arising from opportunities post-merger for the integrated firm to engage in foreclosure or raising rivals' costs. Practitioners should pay close attention to the discussion of how the agencies determine if the merged firm has the ability and incentive to engage in such behavior, and how we assess the net effects of that conduct after accounting for the elimination of double marginalization.

Regarding the issue of "revitalization," I think there is a narrative, that some commentators have simply accepted without evidence, that the agencies are lax in merger enforcement. They typically cite several mergers that are six or eight years old to condemn the Commission's entire merger enforcement regime. Most people would quibble about the outcome on one or two particular mergers (probably different ones), but I simply reject the overall premise. There is no need to revitalize merger enforcement because it has not been lagging.

Let's look at the recent level of enforcement. So far in the current fiscal year, the Commission is on pace to have the highest number of merger challenges, abandonments, and settlements since the HSR thresholds were raised twenty years ago. This level of activity is remarkable, but even more so if you consider that we have been operating under mandatory telework for half the fiscal year in the wake of global pandemic. More importantly, we are not shying away from hard cases. For instance, we have been willing to look at multiple theories in merger reviews. Two of our merger reviews this year include not just Section 7, but also Section 1 and Section 2 claims. We are also currently litigating two monopolization cases in federal district court. And we are willing to accept some litigation risk, because we are not going to win every case. I think our record demonstrates that we are already willing to employ the tools that we have to aggressively combat anticompetitive mergers and conduct. We will continue to question whether there is more that we could do. That is not evidence of needed revitalization, but rather of constructive self-reflection.

SOME OBSERVATIONS ON CLAIMS THAT RISING MARKET POWER IS RESPONSIBLE FOR U.S. ECONOMY ILLS AND THAT LAX ANTITRUST IS THE VILLAIN



BY DENNIS W. CARLTON[1]

1 Booth School of Business, University of Chicago.

I. INTRODUCTION

There has been an outpouring of scholarly articles in economics linking increases in market power throughout the U.S. economy to poor economic performance, often with the implication that lax antitrust is a primary cause of the increase in market power. A good deal of this literature has its origins in the macroeconomic literature, but microeconomists also have contributed. The FTC has held hearings on the topic of market power. There has also been a huge non-economic and popular literature calling for increased antitrust enforcement including, for example, breaking-up some large companies. Certain presidential platforms have focused on antitrust in a way not seen since the early 1900s. I will focus only on the economics literature in this essay. But even this literature is so vast that I cannot analyze it adequately in this short essay and instead highlight a few key observations that I have tentatively drawn from some articles in this evolving literature on increases in market power throughout the U.S. economy.[2] I primarily focus on studies covering the U.S. economy in general and not on more detailed and typical industrial organization studies of individual industries. I apologize in advance to authors whose important papers I cannot analyze but I refer the reader to some references[3] that do provide more comprehensive analyses of this literature.

My key conclusion is that although this literature raises issues deserving of continued research, it does not support calls for dramatic changes in antitrust policy. I base this conclusion on the following observations:

1. The facts indicate that industry concentration has increased in many industries, but even if these measures of concentration were a good predictor of competitiveness the fact remains that the U.S. economy is generally characterized by levels of concentration that antitrust economists, based in large part on empirical observations and studies, would not consider to raise significant competition concerns.

2. As Demsetz (1973) pointed out long ago, rising concentration can be a desirable feature of competition as efficient firms expand.[4] There is evidence indicating that the observed increase in concentration and increased productivity go together.

3. However, the implication that such increased productivity would lead to lower prices seems not to have materialized, leading instead to higher price-cost margins, though not to higher prices. The firms that are growing seem to be the ones that are most productive and those are the ones enjoying elevated price-cost margins. Such evidence would be consistent with increased rates of return on measured capital, as seems to be the case. But since consumers are choosing to buy from these growing firms, it suggests that these firms are being rewarded for their products which may well be high quality or innovative; otherwise it is hard to figure out why such firms are expanding.

4. Work by Deloecker, Eeckhout & Ungar (2020), following Hall's (1988) pioneering work, suggests a very large increase overall in the U.S. ratio of price to marginal cost (ranging from 33 to 45 percent, depending on the data set used) over the last 40 years.[5] Other work casts doubt on the magnitude of that increase and smaller increases seem more likely. Plausible estimates find an increase of 5 percent or even less.

5. The increase in the ratio of price to marginal cost appears highest in finance, utilities, and health care, three industries that are subject to numerous state and federal regulations. This suggests that not surprisingly regulation rather than inadequate competitive forces is an important factor explaining increases in the ratio of price to cost in these industries.

6. Technological change is likely an important, if not the most important, influence in altering industry structure and measured price-cost margins. The increased importance of intangible capital and computer technology is an important consequence of this technological change. Elevated price cost margins and elevated returns to measured capital (excluding intangible capital) are what one would expect to see in firms subject to high fixed costs associated with the creation of intangible capital.

7. Attempts to blame increased market power as the primary cause of large declines in labor's share of value added, in productivity growth, in the rate of new business formation and in investment are likely misplaced, though the data raise some puzzling issues that need further investigation.

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2 I only briefly discuss monopsony power here, though that topic deserves more study.

3 See, for example, the symposium in the summer 2019 issue of the *Journal of Economic Perspectives*, especially Chad Syverson, *Macroeconomics and Market Power: Context, Implications, and Open Questions*, 33 J. ECON. PERSP. 23-43 (2019). See also Thomas Philippon, THE GREAT REVERSAL: HOW AMERICA GAVE UP ON FREE MARKETS (2019).

4 Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J. LAW & ECON. 1-9 (1973).

5 Jan DeLoecker, Jan Eeckhout & Gabriel Unger, *The Rise of Market Power and the Macroeconomic Implications*, 135 Q. J. ECON. 561-644 (2020); Robert E. Hall, *The Relation Between Price and Marginal Cost in U.S. Industry*, 96 J. POL. ECON. 921-47 (1988).

8. There can be no disagreement with the claim that antitrust case law can be improved. That has always been true and remains so today. However, the basic framework of the antitrust statutes should be adequate for dealing with competition issues. Claims that antitrust policy has been lax and that drastic changes in antitrust policy are needed often fail to distinguish between whether the laws are inadequate, the agencies are not sufficiently enforcing the laws, or litigation has produced the wrong result. Recommendations regarding tighter merger policy often rely on retrospective studies, several of which show price increases following mergers. But those recommendations often fail to explain how those retrospective studies would enable enforcers to know enough beforehand to identify those mergers that will raise price. The case law seems adequate for dealing with competition problems, with the possible exception of the recent *American Express* case.[6]

9. Other than attempts to control market power on the selling side through antitrust enforcement, there are many other avenues to pursue if one wants to increase competition in the economy. As already mentioned regulations at the state and federal level, misuse of intellectual property protection, and contractual restrictions on workers are some of the prime candidates to examine.

10. Antitrust is not regulation. The history of regulation especially in rapidly changing industries is not encouraging for thinking that regulators perform better than the market even when some markets are highly concentrated. But, of course, that does not mean that there should never be additional regulation, just that the nirvana fallacy — that regulators can costlessly improve market performance — should not dominate decision-making.

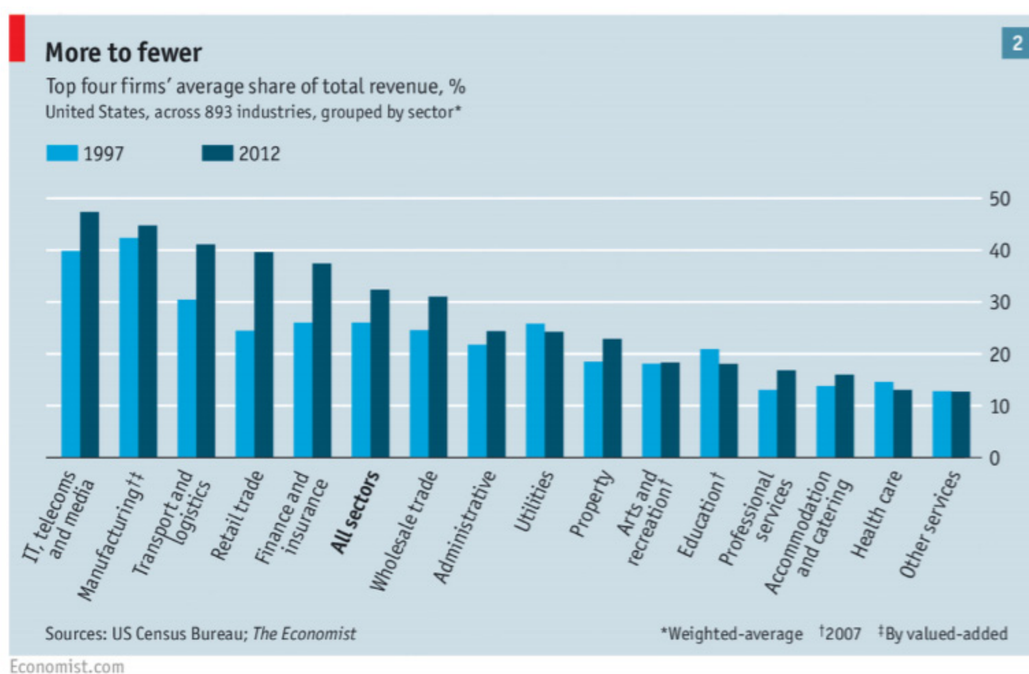
I would also add that continued study of these topics is not only needed to advance the knowledge of academic researchers but also to inform policy of what to do and not to do. Let me now explain my reasoning behind these observations.

6 *Ohio et al. v. American Express Co. et al.*, 138 S Ct 2274 (2018). Although I did not testify as an expert in that matter, I have appeared in other matters as an expert adverse to credit card companies.

II. IS CONCENTRATION IN THE U.S. ECONOMY RISING TO LEVELS THAT RAISE ANTITRUST CONCERNS?

The general answer to this question is no, though it is undeniably true that some industries have become more concentrated. Most antitrust economists pay attention to an HHI (the squared sum of market shares) or perhaps CR4 (the aggregate market share of the four largest firms) as initial possible indicators of competition once an antitrust market has been defined.[7] As is well-known, it is not a trivial task to define the product and geographic scope of an antitrust market, but no study of the U.S. economy could do that for every relevant antitrust market. So, most studies rely on some variant of using readily available data. That of course can be a serious problem, but even if one uses such data, it does not support the conclusion that the antitrust critics claim. For example, consider the chart below that appeared in Shapiro's 2018 article.[8] It shows that across the U.S. economy concentration indeed increased from 1997 to 2012 but overall CR4 is on average only around 30 percent. Even in the most highly concentrated sectors, the CR4 remains below 50 percent, a level that many antitrust economists would consider to be so low that competitive concerns do not arise. And this is under the assumption that the measured levels of concentration and its increases over time are good indicators of competitiveness or the change in competitiveness in the relevant industries.

Figure 1



Source: Shapiro (2018), p. 728.[9]

An analysis covering a longer time period is based on the work of Peltzman (2020) who examined and adjusted manufacturing data to enable an analysis of concentration over the 1982 to 2012 period for about 300 industries.[10] There are no doubt limitations to the underlying data (*e.g.*, imports are excluded) as Peltzman clearly acknowledges, but using the data that Professor Peltzman kindly provided, I created Figure 2 which shows how HHI has evolved over time for the industries in his data set. What the figure shows is that, generally, concentration in U.S. manufacturing is not at levels that U.S. antitrust authorities would consider troubling and that despite a trend toward increasing concentration, it would be inaccurate to suggest that U.S. manufacturing industry is concentrated. For example, about 85 percent or more of manufacturing industries in both 1982 and 2012 are in the "unconcentrated" category, with HHIs under 1500.

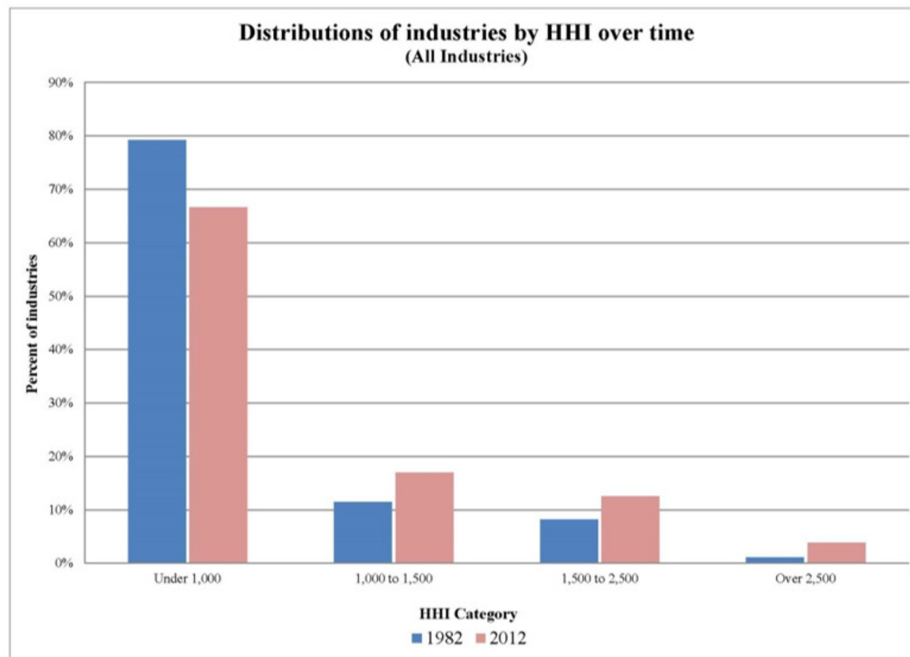
7 The Council of Economic Advisers ("CEA") published a report in 2016 sounding the alarm about increased concentration but relied on measures such as the share of the top 50 firms that most antitrust economists would not consider meaningful. Council of Economic Advisers, *Benefits of Competition and Indicators of Market Power*, CEA ISSUE BRIEF (April 2016).

8 Carl Shapiro, *Antitrust in a Time of Populism*, 61 INT. J. IND. ORG. 714-48 (2018).

9 *Id.*

10 Sam Peltzman, *Productivity, Prices and Concentration in Manufacturing: A Demsetzian Perspective*, working paper (2020).

Figure 2



Source: Data from Peltzman (2018).[11]

III. HAS INCREASED CONCENTRATION LINKED TO INCREASED MARKET POWER?

As Demsetz (1973) pointed out long ago, efficient firms grow and their growth would be expected to lead to increased concentration.[12] This is just one possibility, of course, and increased concentration can sometimes harm consumers. What do the data show? Peltzman (2020) studies this question in some detail for manufacturing.[13] He finds that increased concentration and increased productivity seem to go hand in hand: Industries with increasing concentration, especially industries with initially higher levels of concentration, enjoy increased productivity.[14] This sounds good for the story that there is really nothing undesirable or unexpected going on when we observe concentration increasing over time. But Peltzman also finds that this increase in productivity, which should translate into lower costs, does not result in lower prices as concentration increases, though it also does not result in higher prices either. Although there may be explanations for this (such as improved product quality), such evidence raises the question of why competition in the market does not lead to lower prices. It also suggests that even though prices may not have increased, price-cost margins have likely increased over this time period, a theme I will return to below. Ganapati (2018) finds similar results to Peltzman for all industries.[15]

Bessen (forthcoming) has studied the role of firm investment in proprietary software across the U.S. economy.[16] He identifies when a firm invests in IT software of their own and then traces the relationship between such investments and increased industry concentration. To provide some idea of the importance of these investments, firms invested about $250 billion in in proprietary software in 2016, which Bessen reports is nearly as much as all private, nonresidential investment in equipment and structures. Bessen finds that most of the increase in concentration can be explained by focusing on this technological channel by which firms become more efficient.

11 *Id.*

12 Demsetz, *supra* note 4.

13 Peltzman, *supra* note 10.

14 See Blonigen & Pierce (2016) for some counter evidence showing that mergers do not appear to lead to increased productivity. Bruce A. Blonigen & Justin R. Pierce, *Evidence for the Effects of Mergers on Market Power and Efficiency*, NBER WORKING PAPER 22750 (Oct. 2016).

15 Sharat Ganapati, *Growing Oligopolies, Prices, Output, and Productivity*, WORKING PAPER, GEORGETOWN UNIVERSITY (2018).

16 James Bessen, *Industry Concentration and Information Technology*, J. LAW & ECON. (forthcoming).

Adding to this evidence of increased concentration reflecting increased efficiency, Autor, *et al.* (2020) show that so-called "superstar firms" have expanded where such firms have higher productivity implying lower costs, all else equal, and higher price-cost margins than their rivals.[17] If consumers are buying more from these firms than from their rivals, and especially in the absence of evidence of price increases, it likely reflects that these firms are doing something right, providing desirable new products, better products, or both.

IV. HAS MARKET POWER INCREASED IN THE U.S. ECONOMY?

Starting with Hall's (1988) pioneering study, studies that usually would be characterized as part of the macroeconomic literature have looked at how to measure market power.[18] Perhaps the most noteworthy of such recent studies and the one that has attracted lots of attention is the impressive study by DeLoecker, *et al.* (2020).[19] They explain that the ratio of price to marginal cost can be measured as the ratio of an output elasticity to the share of a variable factor of production, where the output elasticity is the percentage change in output in response to a one percent change in the variable factor. A variable factor of production is one with no adjustment costs such as labor which is often (perhaps wrongly) assumed to be easy to increase and decrease at a constant wage. They find that the ratio of price to marginal cost rose by about 33 or 45 percent (depending on which data they use) from 1980 to 2014. That is certainly enough of an increase that it should capture everyone's attention, and it has. They also find, like Autor, *et al.* (2020), that aggregate mark-ups increase because large firms with high mark-ups expand their share.[20] Again, this suggests that these large firms must be providing consumers some benefit over and above other firms. That is good, not bad, for consumers.

There have been numerous criticisms of DeLoecker, *et al.*'s work, though that should not detract from the value of their study in stimulating research on an important topic. Some of the most important critiques concern their methodology. First, if a factor of production, such as labor, really entails adjustment costs in the sense that it takes time and effort to train and add labor to the work force, then ignoring these adjustment costs would bias the results of the estimation. Second, if wage payments include some fixed component of compensation that does not vary with hours worked, then that too will bias the calculation and lead to an incorrect measure of labor's share relevant for DeLoecker, *et al.*'s methodology. Third, in theory it should not matter which "variable" factor of production one uses to do the estimation, but, in practice, it does matter (see Raval (2020)[21]) and one obtains lower estimates of markups if one uses other factors of production that exclude labor. Fourth, DeLoecker, *et al.* assume that technological change is "Hicks neutral." (This basically means that the production function that depends on capital and labor grows over time by being multiplied by a productivity number.) If technological change is not Hicks neutral but instead reflects primarily more productive capital, then this too matters to the calculation. Fifth, suppose one treats SGA (selling, general and administration expense) as a variable cost, not a fixed cost, because an analysis of SGA shows that it rises with output rather than stays fixed as it should if it is a non-variable factor of production. (See Traina (2018)).[22] That too matters for DeLoecher, *et al.*'s calculations. Finally, one potentially devastating criticism of the methodology comes from Bond, *et al.* (2020).[23] They explain that the output elasticity that DeLoecker, *et al.* use incorrectly ignores the fact that when there is market power, prices are affected as one expands output. That means that a revenue elasticity is different from an output elasticity, even though if price remained unaffected, they would be equal. Since Bond, *et al.* explain that DeLoecker, *et al.* use a revenue elasticity, they show that the methodology is fundamentally flawed.

Although there is no consensus yet on the magnitude of the increase, if any, in market power (as measured by the ratio of price to marginal cost) throughout the U.S. economy, my reading of the literature indicates that many of these adjustments lower the large increases that DeLoecker, *et al.* find by considerable amounts. For example, Traina shows that the ratio of price to marginal cost has gone from about 1.15 in 1950 to a low of about 1.10 in 1980 to about 1.15 in 2020. That is an increase of about 5 percent, not 33-45 percent, from 1980 to 2014. Although such an increase is far lower than that found by Deloecker, *et al.*, it still poses the question as to why profitability (rates of return to measured capital) should appear to be rising. This is especially puzzling in the recent period of low interest rates since the usual relationship is that rates of return to capital should be directly related to the interest rate. One answer that Traina suggests is that even his much smaller estimate

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17 David Autor, David Dorn, Lawrence Katz, Christine Paterson & John Van Reenan, *The Fall of the Labor Share and the Rise of Superstar Firms*, 135 Q. J. ECON. 645-709 (2020).

18 Hall, *supra* note 5. To make my biases clear, I regard Hall's work and the related research as central to industrial organization and have long included such studies on my reading lists for my Ph.D. courses in industrial organization.

19 DeLoecker *et al., supra* note 5.

20 See also David Autor, et al., *supra* note 17.

21 Devesh Raval, *Testing the Production Approach to Markup Estimation*, WORKING PAPER (March 2, 2020).

22 James Traina, *Is Aggregate Market Power Increasing? Production Trends Using Financial Statements*, WORKING PAPER (Feb. 2018).

23 Steve Bond, Arshia Hashemi, Greg Kaplan & Piotr Zoch, *Some Unpleasant Markup Arithmetic: Production Function Elasticities and Their Estimation from Production Data*, NBER WORKING PAPER 27002 (April 2020).

of the ratio of price to marginal cost should be adjusted for the changing composition of his data set; once he makes that adjustment, he finds no general increase in market power over the period 1980 to 2016. But other evidence in addition to DeLoecker, *et al.*'s evidence on profitability does suggest that profits appear to have risen.[24] Perhaps complications in measuring returns to capital such as measuring the value of intangible capital complicate the calculations. But again, as discussed already, even if such returns have risen, the evidence discussed earlier suggests that that may reflect that consumers are choosing to buy new and better products from innovating firms that are being rewarded for their efforts.

Hall (2018) provides some additional clues as to what is going on with mark-ups. Hall presents a new derivation for calculating the ratio of price to marginal cost and then applies it to recent data.[25] Like DeLoecker, *et al.*, Hall finds that market power is increasing over the time period he considers (1988-2015), as measured by the price-cost ratio; but Hall's estimates of the increase is much less than DeLoecker, *et al*. Hall's method shares some of the same problems as the DeLoecker, *et al*. methodology. But the interesting part of the Hall paper I want to focus on are his estimates of the growth in market power by sector of the U.S. economy. Hall reports in his Table 4 that of the 19 sectors on which he reports, the top three in terms of growth in market power are Finance and Insurance, Utilities, and HealthCare and Social Assistance, with the first one the clear leader in growth of market power. The one striking fact to me regarding these industries is that many of them are highly regulated, suggesting that regulation may be the primary cause of any decrease in competition in these industries.[26] In contrast, Hall finds that manufacturing seems to have had only tiny growth in its price-cost ratio over the time period he studies.

V. IS INCREASED MARKET POWER RESPONSIBLE FOR POOR PERFORMANCE OF THE U.S. ECONOMY?

Some have suggested that increased market power is responsible for the especially poor performance of the U.S. economy on a number of dimensions. These dimensions include decreased share of value added going to labor, low productivity growth, depressed rate of new business formation, and low investment. If the evidence is as the prior sections suggest — namely some increase in market power between 1980 and today reflected in an increase in price-cost ratio from 1.10 to 1.15, a level that also existed in 1950 — then it raises the question whether it is sensible to attribute a large decline in performance to such an increase in market power. (And the answer to the question depends on what "large" means.) In any event, let's look at each measure of performance and see if there is any obvious relation to increased market power over the past several years. Such an analysis does not substitute for a more sophisticated analysis, of course, but it can be helpful in figuring out initially if there likely is strong evidence linking an increase in market power to a decline in a variety of performance measures in the national economy. Let me raise one caveat: Macroeconomics is concerned with movements in aggregate measures of performance for the entire economy and I will focus on those. I do not discuss individual industries and recognize, as readers surely do too, that the answers for individual industries could differ.

Let's consider first the share of value added going to labor. One claim is that the increased market power of firms has been used to offset whatever bargaining power workers have and that this has led to labor having a lower share of value added. That share was fairly stable in the U.S. at around 66 percent until about 1980, and then it fell fairly steadily to about 58 percent in 2012.[27] The problem with attributing this decline to market power is that such a decline is evident throughout much of the world, including in economies that supposedly did not suffer the same increase in market power as did the U.S.[28] For example, the decline in labor's share in Germany was similar to that in the United States.[29] This suggests that technological conditions are the driving force of this change in labor's share of revenue, as labor is being replaced by capital, or, alternatively, that there is an increase in the effective supply of labor (through, for example, globalization).

Now consider productivity growth. I have reproduced a figure from Robert Gordon's excellent book (2017) on technological change.[30] Figure 3 shows the decline in the 10-year rate of productivity growth over time. As the figure makes clear, (except for the 1980 figure) that decline has been pretty steady since 1950 and has, if anything, tapered off over the last couple of decades. Based on this figure, it is hard to see an association between the recent claimed increases in market power and the observed decline in productivity growth since 1950.

24 See, e.g. Philippon, *supra* note 3, chapter 3.

25 Robert E. Hall, *New Evidence on the Markup of Prices over Marginal Costs and the Role of Mega-Firms in the US Economy*, NBER WORKING PAPER 24574 (May 2018).

26 In health care, there have been numerous, detailed studies showing how several (though not all) mergers and increased concentration in the health care sector have led to a decline in competition. See Martin Gaynor, Kate Ho & Robert Town, *The Industrial Organization of Health Care Markets*, 53 J. ECON. LIT, 235-84 (2015).

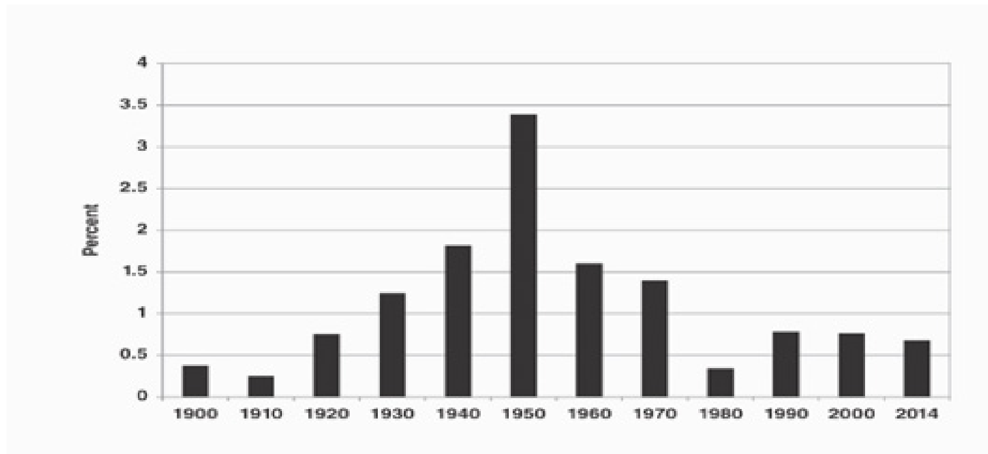
27 Loukas Karabarbounis & Brent Neiman, *The Global Decline of the Labor Share*, 129 Q. J. ECON. 61-103 (2014).

28 See Philippon, *supra* note 3, chapter 6.

29 Karabarbounis & Neiman, *supra* note 27.

30 Robert J. Gordon, THE RISE AND FALL OF AMERICAN GROWTH (2017).

Figure 3: 10-Year Average Annual Growth in Total Factor Productivity

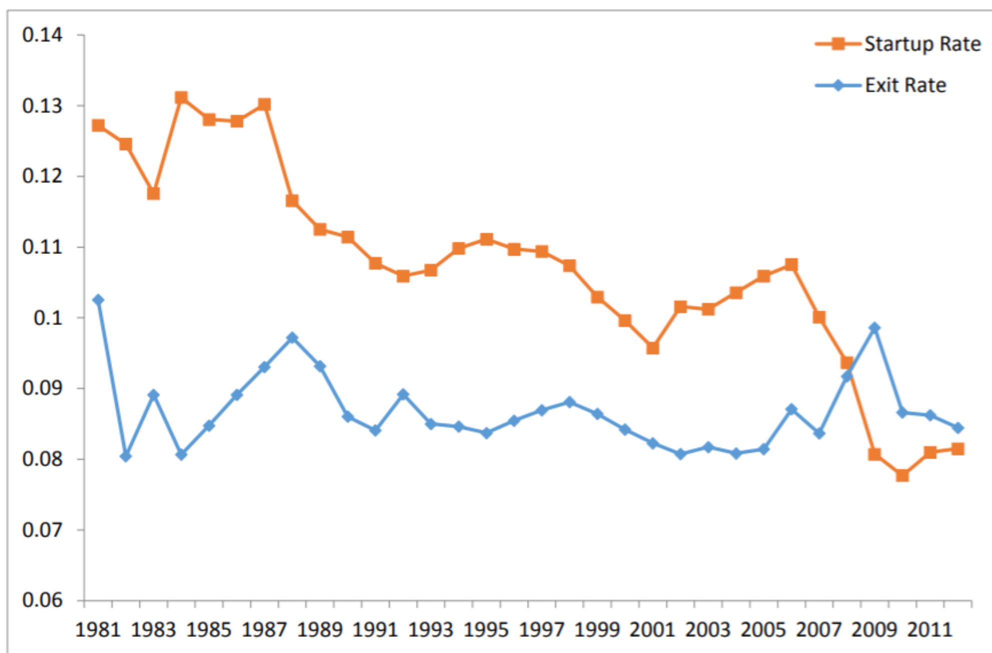


Source: Gordon (2017).[31]

Note: The average annual growth rate is for the ten years prior to the year shown, and the bar labeled 2014 shows the average annual growth rate for 2001-14.

Let's next turn to the rate of new business formation. I have reproduced a chart from Haltiwanger (2015) showing that new business formation has declined by over 30 percent since 1981.[32] This is a potentially troubling fact and deserves further research. But one can note that the decline has been pretty steady since about 1990 and has been especially severe since the Great Recession.

Figure 4: Startup and Exit Rates for Firms in the U.S. Non-Farm Sector, 1981-2012



Source: Haltiwanger (2015), figure 2a, p. 16.[33]

31 *Id.*

32 John Haltiwanger, *Top Ten Signs of Declining Business Dynamism and Entrepreneurship in the U.S.*, WORKING PAPER (Aug. 2015).

33 *Id.*

Although it is possible that market power, to the extent one reads the evidence as showing large increases over time, could be a factor, Hopenhayn, *et al*. (2018) have provided another explanation in which demographics explain most, if not all, of what is going on.[34] Old workers do not typically start new firms, and the aging of the U.S. workforce means that one should expect that the U.S. will generate fewer start-ups than in the past, all else equal. This should not necessarily be taken as the full explanation but I think it is plausible and find their evidence persuasive. Moreover, entrants tend to be small and a small firm has more difficulty than a large firm in overcoming any fixed costs, including the fixed costs of investing in intangible capital or of adhering to regulations. It is plausible that such costs have risen over time. Finally, I note that according to the World Bank, although the US economy ranks 6th out of about 200 countries in terms of the overall ease of doing business in 2020, it ranks 55th (better than Niger but worse than the Democratic Republic of Congo) in terms of how easy it is to start a business.[35] It is possible that impediments to starting a new firm are higher now because of the increased market power of an incumbent, but I would need to see more evidence to be convinced that it is a general phenomenon, especially in light of alternative plausible mechanisms.

Finally, let's evaluate the claim that increased market power is the cause of low investment. A monopolist restricts output, and therefore in steady state needs less capital, and hence less investment, than do firms in a competitive industry. Philippon (2019) has estimated that the U.S. capital stock is about 10 percent lower than it would be had the increase in market power not occurred.[36] Of course, if the increase in market power is coming from the introduction of a new product, then asking whether the capital stock would be greater had the firm invented the new product but charged a lower price is a strange question to ask. It would seem that we should applaud the firm for the introduction of the new product at whatever price it chooses to charge and at which consumers are willingly purchasing. Interestingly, this estimate of 10 percent lower capital stock is about the magnitude of what one might expect if, all else equal, prices rose by about 10 percent because of increased market power and the demand elasticity was near 1. One might want to consider, of course, the impact of other factors affecting investment such as the increased uncertainty in the wake of the Great Recession. Still, I do find that Philippon's evidence on this point raises valid concerns that merit further investigation.

VI. IS LAX ANTITRUST RESPONSIBLE FOR A RISE IN MARKET POWER AND, IF SO, WHAT SHOULD BE DONE?

Among the calls for antitrust reform, it is useful to distinguish between calls for legislative change, enforcement change, and somehow altering how judges interpret the antitrust statutes. My own sense, reflecting in part my experience on the Antitrust Modernization Commission, is that the antitrust laws are basically on target, although some improvements to various provisions undoubtedly could be made. The antitrust laws reflect the ideas that cartels are bad, mergers that create market power are bad, and firms with market power should not engage in conduct that enhances or maintains that power without benefitting consumers. Those basic ideas seem correct to me, and so I see no basis to ask for a dramatic rewriting of our antitrust laws.

What about enforcement? Are the government agencies doing a good job in enforcing the laws or not? This is a hard question but no matter what one thinks, if one thought that an agency was doing a good job some time ago then as the economy expands one has to recognize that that level of performance likely requires increased resources. For the Antitrust Division at the Department of Justice, the ratio of total funding appropriated to GDP has fallen by about 30 percent since 2000.[37] One disturbing finding of Wollman (2019) is that as reporting thresholds for mergers have increased, a surprising number of mergers that took place fell just below the reporting thresholds.[38] That at least raises the possibility that mergers are getting through because of inadequate scrutiny, suggesting that some anticompetitive mergers may be overlooked.

There has been a concern that too many anticompetitive mergers are going unchallenged. The evidence supporting this concern is based largely on retrospective studies of allowed mergers. Kwoka (2015) summarizes several of these studies, as does Ashenfelter, *et al*. (2014).[39] Such studies can be criticized on a number of grounds, most importantly as to whether the mergers studied are representative of mergers today

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34 Hugo Hopenhayn, Julian Neira & Rish Singhania, *From Population Growth to Firm Demographics: Implications for Concentration, Entrepreneurship and the Labor Share*, NBER WORKING PAPER 25382 (Dec. 2018).

35 World Bank Doing Business 2020: https://www.doingbusiness.org/en/data/exploreeconomies/united-states.

36 Philippon, *supra* note 3.

37 U.S. Department of Justice, "Appropriation Figures for the Antitrust Division, Fiscal Years 1903-2021," https://www.justice.gov/atr/appropriation-figures-antitrust-division.

38 Thomas G. Wollman, *Stealth Consolidation: Evidence from an Amendment to the Hart-Scott-Rodino Act*, 1 AM. ECON. REV.: INSIGHTS 77-94 (2019).

39 John Kwoka, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY (2015); Orley Ashenfelter, Daniel Hosken & Matthew Weinberg, *Did Robert Bork Understate the Competitive Impact of Mergers? Evidence from Consummated Mergers*, 57 J. LAW & ECON. S67-S100 (2014).

since several of the mergers studied are from long ago and are concentrated in a few industries (*e.g.*, hospitals, airlines, and banking).[40] Those studies do not necessarily show that the government systematically underestimates adverse effects of mergers, as Carlton (2009) explained, because they and are not a random sample of mergers.[41] Although I agree with the criticisms of retrospective studies, I cannot see that researchers surveying the literature have a choice other than to report the existing studies. The conclusion I draw from these retrospectives is similar to that of Ashenfelter, *et al*. (2014). The evidence refutes the notion that mergers in industries with only a few firms will always be pro-competitive. The evidence also refutes the notion that mergers in concentrated industries are always anti-competitive. The message to the policy maker is not to dismiss competitive concerns too quickly in concentrated industries, but also not to jump to the conclusion that mergers in concentrated industries should be stopped. Moreover, the evidence shows that generally, even if these studies could be assumed to be based upon a representative sample of mergers and if the price increases could be associated with the merger, the price increases are often below 5 percent.[42] Hence the message also is that attributing large (e.g. 45 percent) increases in the ratio of price to marginal cost across the entire U.S. economy to lax merger enforcement seems like a stretch especially since not all industries experience mergers that significantly increase price.

From a policy point of view, these retrospective studies raise a deeper point that I once made[43] and that I want to repeat. For retrospective merger analysis to have policy relevance, the studies need to show that the agency, with the information it had at the time, incorrectly estimated the merger's effect. Is there a systematic bias that leads the FTC or DOJ to underestimate price effects? Showing that some mergers raise price by 10 percent while others lower price by 10 percent tells the policy maker nothing unless one can tell him what he is doing wrong and how to predict in advance which mergers will raise price. Stopping all mergers in order to prevent ones that raise price is the wrong lesson to draw, especially since most mergers raise few, if any, competition issues. For economists, that means evaluating the models and methods used to analyze the merger. The government agencies are the ones best suited to know what models they used or did not use, and to evaluate which of those models did a good job and which did a poor job of predicting the merger effect. Is there another mode of analysis that was not pursued that would have predicted an adverse effect? It is only with that type of retrospective analysis, admittedly time-consuming and requiring post-merger data, that merger policy can significantly improve its methodology.

One cannot ignore that, in addition to stopping a particular anticompetitive merger or particular anticompetitive conduct, there are other policy considerations in bringing an antitrust case that affect the government's enforcement decisions. One important concern that has received little, if any, attention from proponents of more aggressive antitrust enforcement is the effect of aggressive enforcement on reducing desirable merger activity or otherwise efficient conduct for fear of mistaken prosecution or of triggering a lengthy and costly process. That is a hard policy question to evaluate but it is not possible to have a sensible policy without making at least some attempt to assess that issue.

Enforcement decisions are also affected by the case law, not simply by the agency's (or a private party's) assessment of whether an anticompetitive effect is likely. Why bring an antitrust case if the case is sure to fail because of the case law? The question therefore becomes whether the existing case law is significantly off-track. For the most part, I think the judicial framework for figuring out whether a merger or some individual firm conduct will lead to harm is sensible in that the overall economic effect of the merger or conduct is considered, though reasonable parties can disagree about whether the courts are getting it correct in particular cases. But that is where the beauty of the case law should work. For example, if studies show undesirable effects of, for example, mergers in a particular industry, then that evidence can be explained at trial. There are plenty of smart economists that can rely on their own case research as well as studies in the literature to convince a judge or jury that a merger is bad.

There is, however, one important recent antitrust decision that may have far-reaching, undesirable consequences in today's economy but hopefully will not. In what I consider a very muddled decision in *American Express*,[44] the Court ruled that when firms operate in a two-sided market, under certain circumstances the plaintiff has a burden, normally borne by the defendant, to analyze the total (including pro-competitive) effect of conduct in an antitrust market that consists of both sides of the market in order to get past the first hurdle in a trial. This ruling will make it harder for plaintiffs to succeed in an antitrust case against a firm in a two-sided market than was true prior to the decision. Although

40 See, e.g. Michael Vita & F. David Osinki, *John Kwoka's MERGERS, MERGER CONTROL, AND REMEDIES: A Critical Review*, 82 ANTITRUST L.J. 361-388 (2018).

41 Dennis Carlton, *Why We Need to Measure the Effect of Merger Policy and How to Do It*, 5 COMPETITION POLICY INT. 77-90 (2009).

42 See Orley Ashefelter & Daniel Hoskins, *The Effect of Mergers on Consumer Prices: Evidence from Five Mergers on the Enforcement Margin*, 53, J. LAW AND ECONOMICS 417-466 (2010). Kwoka (2015) *supra* note 38 at p.96 finds an average price increase of about 5 percent from the merger studies he reports. Of course, there can be mergers in specific industries that are harmful to competition. Studies of certain past airline mergers find price increases above 5 percent. However, although there has been much criticism heaped on the recent airline mergers, the evidence does not show that such mergers led to adverse effects on routes that would have been predicted to become more concentrated as a result of the merger. See Dennis Carlton, Mark Israel, Ian MacSwain & Eugene Orlov, *Are Legacy Airline Mergers Pro- or Anti-Competitive? Evidence from Recent U.S. Airline Mergers*, 62 INT. J. IND. ORG. 58-95 (2019).

43 Carlton (2009), *supra* note 41.

44 *American Express*, *supra* note 6.

the exact definition of an antitrust market can sometimes be helpful, it is not helpful if legal formalism precludes consideration of an undisputed adverse effect.[45] *American Express* has already affected subsequent antitrust cases. For example, Sabre's recent attempt to purchase Farelogix was challenged by the government. Sabre provides software that enables airlines and travel agents to book tickets for passengers. Farelogix provides software that enables airlines to book passengers. Relying on *American Express*, the district court denied the government challenge to the merger since Farelogix did not compete in the same two-sided market that Sabre did, despite evidence that the court credited that Farelogix was a competitive influence on the pricing of Sabre.[46] The UK competition authority blocked the merger and the merger was called off, at least for now. In our common law system, hopefully the adverse effects of *American Express* can be limited by subsequent rulings.

The Antitrust Modernization Commission, a bi-partisan Congressionally authorized committee, issued a report in 2007 providing a comprehensive review of antitrust policy based on several years of hearings and studies. It looked at not just the need for legislative change but also suggested where the case law needed redirection. That report is now almost 15 years old. Since that time numerous changes in the economy have occurred and case law has further developed. Given the heightened scrutiny of antitrust today, it may well be appropriate to consider another such study.[47] Indeed, the FTC's recent Hearings on Competition and Consumer Protection in the 21st Century may provide useful information for such a study.[48]

VII. WHAT FACTORS ARE THERE OTHER THAN ANTITRUST THAT COULD IMPROVE COMPETITION?

Aside from antitrust, there are many other factors that affect competition and thereby the performance of the U.S. economy. I will mention just a few that I would urge policy makers to examine if they wish to promote competition.

The notion that an incumbent has an incentive to restrict competition in its industry is an easy one for an economist to understand, as is the harm such restrictions create. State licensing boards are a good example of such restrictions. Over the last 50 years, the number of professions requiring licenses has exploded. The fraction of the work force subject to some requirement for licensing has risen from about 5 percent in the 1950s to over 25 percent.[49] Although some licensing can be justified, it is hard to believe that someone selling flowers, for example, should need a license in one state but not another. Moreover, in healthcare, the various and varied state rules restricting use of dental assistants or physicians' assistants strikes an unbiased observer as lacking justification. The health sector in particular has drawn scrutiny because of its many regulations including banning new hospitals unless a regulator determines that one is "needed." Local rules restricting distribution of liquor are another example.

Regulations generally harm small businesses compared to larger firms to the extent that there is a fixed cost associated with complying with the regulations. This implies that having lots of regulation is incompatible with having lots of small firms, all else equal. I have already mentioned that the United States ranks 55 out of about 200 countries in the World Bank survey of how hard it is to start a business. That does not mean that there should be no regulations but those proposing regulations should understand the consequences of their actions.

The creation of intellectual property is a driving force for technological change. But too much protection of intellectual property can be harmful to technological change. This could occur, for example, when owners of standard essential patents (patents that are required to be used if one must meet an industry standard), protected by IP laws, charge high royalties to exploit *ex post* market power after a standard is set, and standard setting organizations fail to institute mechanisms to prevent this exploitation.

Finally, contractual terms in labor contracts that could plausibly protect intellectual property (such as restrictions governing where a former employee can work if the employee has firm-specific intellectual property such as a customer list) could also have adverse effects on competition. Although it is easy to justify such terms in certain circumstances, it is somewhat surprising that about 20 percent of workers are covered by such

45 See Carlton & Winter (2018) and the dissent by Justice Breyer in *American Express* for a discussion of several economic mistakes in that decision. Dennis Carlton & Ralph A. Winter, *Vertical MFN's and Credit Card No-Surcharge Restraints*, 61 J. LAW & ECON. 215-52 (2018).

46 I was not involved in this matter. I was involved in a case on behalf of American Airlines adverse to Sabre in 2012.

47 I was the only economist serving on that 12 member Commission. I would recommend having more than one economist if another such commission is created.

48 Information on the hearings can be found at https://www.ftc.gov/policy/hearings-competition-consumer-protection#:~:text=The%20Pitofsky%20Hearings%20were%20the,on%20private%20parties%20or%20governmental.

49 Morris Kleiner & Alan Kruger, *Analyzing the Extent and Influence of Occupational Licensing on the Labor Market*, J. of LABOR ECONOMICS,31 (2) S173-202.

terms, including workers with low incomes.[50] Such terms not only reduce worker mobility, creating the possibility of monopsony or bargaining power, but also can prevent the efficient allocation of labor. Again, this is an area worthy of further investigation.

VIII. CONCLUSION

The recent literature claiming large increases in market power and a decline in competition generally in the U.S. economy raise issues deserving of continued research but do not justify drastic changes to antitrust policy.

Nor should that literature be used to justify calls for the replacement of antitrust with regulation. Calls for widespread regulation of economic activity or the breakup of large firms seem to me extreme based on the evidence. The notion that a regulator can solve problems better than markets may sometimes be true, but I caution that those calling for enhanced regulation should remember the historical experience with regulation in the United States, including the possibility that the regulators will protect the regulated firms and harm, not help, consumers.[51] It is hard to regulate a firm, especially one engaged in a rapidly changing industry. Furthermore, breaking up an efficient large firm into several firms does not solve the problem of efficient production unless one can somehow figure out how to preserve scale efficiencies.

We should keep the basic antitrust structure in place and improve it, not dismantle it.

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50 Evan Starr, J.J. Prescott & Norman Bishara, *Noncompetes in the U.S. Labor Force*, J. LAW AND ECON. (forthcoming). Restrictions on worker mobility between independent firms raise different issues that those between franchisees of the same franchisor.

51 See Dennis W. Carlton & Randall C. Picker, *Antitrust and Regulation*, in Nancy L. Rose ed., ECONOMIC REGULATION AND ITS REFORM: WHAT HAVE WE LEARNED? (2014).

REGULATING MULTISIDED PLATFORMS? THE CASE AGAINST TREATING PLATFORMS AS UTILITIES

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I. INTRODUCTION

The bloom is off the Big Tech rose. It seems nearly the entire political spectrum is angry with Amazon, Google, and Facebook for one reason or another. This has led to a great deal of discussion on whether and how to regulate (or even break up) these platforms, including whether they should be regulated as utilities.[2] Over the last several years, if there is one issue which might support a somewhat broad political consensus it is the desire to regulate large internet platforms like Amazon, Google, and Facebook.[3]

Our purpose with this article is simply to caution against some forms of regulatory treatment which emphasize the utility-like nature of large platforms.[4] We choose the word "caution" because we are not necessarily arguing that such regulation is in all instances inappropriate or uncalled for. Instead, all we mean is that there are counterarguments which should be considered, and in this article, we give voice to some of those arguments.

The basic economic argument for utility-like regulation of internet platforms is that these platforms can become "natural monopolies" which tend to forestall competition. While there is merit to this argument, internet platforms have also been a source of tremendous innovation which in turn has allowed entrants to unseat what were once thought to be entrenched incumbents. Regulation risks quashing such innovation and harming consumer welfare.

Furthermore, internet platforms, unlike traditional utilities, are sometimes amenable to multi-homing, meaning that customers of one platform may also choose to be customers of additional similar platforms. Multi-homing can be critical in enabling successful entry into the market.

While examples of entry do not disprove the possibility of market power abuse by some platforms, they do remind us that the economics of platforms can be more complex and nuanced than the classical utility model would suggest.

II. THE NATURE OF PLATFORMS

What do we mean by a "platform?" For our purposes a platform is essentially a network. It could be "one-sided," such as a purely social networking site which is funded by subscribers. It could also be "multi-sided," such as Uber which brings together a network of passengers with a network of drivers.[5]

What makes networks interesting from an economic perspective is the "network effect." Essentially this means that the value of the network is increasing in the size of the network. Take the case of a one-sided social networking site. Such a site is valuable only because and to the extent that it supports a large network, i.e. a large number of subscribers. A social networking site with no subscribers has no value.[6] The same principle is true in two-sided networks such as Uber. Uber is valuable to drivers only to the extent that it supports a large network of passengers and vice versa from the passengers' perspective.

Economists often refer to these effects as "direct" and "indirect" network effects. The direct network effect describes the phenomenon whereby an additional subscriber increases the value to other subscribers and thus tends to induce additional subscriptions. The indirect network effect describes the phenomenon whereby an additional subscriber on one side (say, an additional driver for Uber) increases the value to subscribers on the other side (passengers), which induces an increase in passenger subscriptions, which then feeds back to induce an increase in driver enrollment.

The distinctions between one-sided and multi-sided platforms or between direct and indirect network effects, while important in other contexts, are not essential to our discussion here. We shall simply refer to platforms or networks, without distinguishing whether they are one- or multi-sided, and to network effects, without distinguishing whether they are direct or indirect.

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2 See, for example, Jamison, Mark, 2012. "Should Google Search Be Regulated As Public Utility?, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027543.

3 See, for example, Constine, Josh, 2018. "House rep suggests converting Google, Facebook, Twitter into public utilities." *TechCrunch*, available at https://techcrunch.com/2018/07/17/facebook-public-utility/.

4 There are other, more normative regulatory arguments which we do not address. For instance, some would argue that regulatory pressure is needed to protect certain political points of view from discriminatory treatment. Such arguments are more matters of public policy than positive economics.

5 Social networking sites such as Facebook which are in fact funded by advertisers, are also considered examples of two-sided platforms.

6 Strictly speaking, it would not attract any subscribers at any non-negative price. Of course, it could pay people to subscribe.

III. NATURAL MONOPOLIES AND BARRIERS TO ENTRY

Economists describe certain business models as *natural monopolies*. These are economic centers which enjoy natural barriers to entry, barriers which forestall competitive entry and which consequently allow the economic center to enjoy surplus profits (what are called "economic profits"). They are also cases where, in general, social welfare could be maximized by allowing just one provider rather than multiple.

The ideal of perfect competition is that the entry of competitors will continue so long as economic profits are being earned. This entry will stop only when economic profit is 0. This is an equilibrium condition, since if profit were still positive, entry would continue, and if it were negative, some firms would exit.

To the extent an industry is characterized by a barrier to entry, this mechanism breaks down. There is no market mechanism to prevent positive economic profits in perpetuity when it is difficult to enter the market. Other market participants undoubtedly observe these profits but are unable to effectively enter and compete against the incumbent firm.

The textbook model of a natural monopoly describes the case of increasing economies of scale, or decreasing marginal costs of production. If the company produces 100 widgets, the marginal cost of the 100th widget is $10. If it produces 200 widgets, the marginal cost of the 200th widget is $5. As the company grows, its marginal cost falls and therefore the price it can charge to customers may also fall while still allowing the company to remain profitable. As the firm lowers its price it sells more widgets and thus moves along its cost curve in a virtuous (from its point of view) cycle, stopping only at the point which maximizes profits.

This makes competitive entry very difficult, since the incumbent can win any resulting price war with an entrant who produces otherwise identical widgets but is not meaningfully more efficient. No matter what price the entrant charges, the incumbent can more easily afford a still lower price. If the widgets are identical, all customers will choose the incumbent's less expensive widgets.

Unconstrained by competition, the natural monopoly can maintain prices above marginal costs and reap positive economic profits. Left alone, the natural monopoly, like any monopoly, charges prices higher than ideal and produces less quantity than ideal. This motivates the economic argument for regulatory control of a natural monopoly, since the company must be compelled to set prices at marginal cost and forego profits which could otherwise be captured.[7]

With economies of scale it is also socially optimal for a single firm to make all the widgets. It is less expensive for one company to make 200 widgets than for two companies to make 100 widgets each, for example. That would not be true were there diminishing returns to scale.

The production of electricity, or the supply of drinking water, are considered examples of this model, and are therefore typically regulated as "utilities" with only one provider per market and with municipal authorities, not private managers, ultimately setting prices.

7 See, for example, Posner, Richard, 1969. "Natural Monopoly and its Regulation," *Stanford Law Review*. 21 (3): 548–643; and Demsetz, Harold, 1968. "Why regulate utilities?" *Journal of Law & Economics*, 11: 55–65.

IV. PLATFORMS AS NATURAL MONOPOLIES

How does this apply to platforms? Economists (and the media in general) have long drawn parallels between platforms and utilities.[8] Facebook even described itself years ago as a "social utility." While of course it is possible that a given platform might benefit from economies of scale just like the power company presumably does, economists usually have something else in mind.

Since a platform is valued because of the size of its networks, the *value* of its product is increasing as the platform grows, rather than the cost of its production decreasing with the firm's growth. Though fundamentally different, positive network effects can lead to a similar result, namely that a large incumbent may have such an advantage that no entrant can effectively compete against it.

Depending on the strength of the network effects, it may also be socially optimal to have a single large network provider rather than multiple smaller providers. Recall that a network effect simply means that a network with 50 percent of subscribers is more valuable, other things equal, than a network with 45 percent of subscribers. But is it a lot more valuable or only a little more valuable?

If the value of the network doubles when the size of the network doubles (if the scale is linear) then the value of two (non-overlapping) networks with 25 percent of the subscribers each is the same as the value of one larger network with 50 percent of the subscribers.[9] Imagine you sell widgets, and you can sell as many widgets as are demanded of you (in other words, you have no capacity constraint). You would typically expect to sell the same number of widgets on one platform with 50 percent of your potential customer base as you would across two (non-overlapping) platforms each with 25 percent of your potential customer base.[10]

On the other hand, if the value of the network more-than-doubles when the size doubles (if the scale is convex) then one 50 percent network is worth more than two 25 percent networks. Think of a telephone network. A network with 3 participants can support 3 unique pairwise conversations, a network with 4 participants can support 6 unique pairwise conversations, and a network with 5 participants can support 10 unique pairwise conversations. The value of the network grows much faster than the size of the network, which we will call "convex network effects." With convex network effects, social welfare would likely be higher with one large provider, rather than with many small providers.[11]

Finally, there is the possibility that the value less-than-doubles when the size doubles (the scale is concave). For example, this might be the case if participants are capacity constrained in some way. Consider a matchmaking network. There is only one of you and you only have so many hours in a week to devote to dating. Beyond a certain point, joining a matchmaking service with twice as many participants may not be twice as valuable to you.[12]

The platform's "barrier to entry" is in the form of the critical mass any network needs to be viable.[13] To operate at a profit, the value of the network to its subscribers must be at least as great as its cost of operation. Since that value is increasing in the number of subscribers, there is some minimum level of subscription – a critical mass – necessary to begin earning profits.

Imagine there is a pool of people who might be interested in participating in a network (for instance, the pool of single people who might be interested in a matchmaking network). Imagine that an incumbent platform already has 50.1 percent of that pool as subscribers. No matter what price the entrant charged, the incumbent could simply match it and be sure of attracting all marginal new subscribers. Why join a network with 49.9 percent when you could join a network with 50.1 percent for the same price? At least initially, no entrant which provides the identical *type* of service can ever provide an identical *quality* of service since no entrant can offer a larger initial network.[14]

8 See, for example, Thierer, Adam, 2013. "The Perils of Classifying Social Media Platforms as Public Utilities," *CommonLaw Conspectus – Journal of Communications Law and Policy*, 21(2); Boyd, Danah, 2012. "Facebook is a utility; utilities get regulated," available at https://www.zephoria.org/thoughts/archives/2010/05/15/facebook-is-a-utility-utilities-get-regulated.html; and Thompson, Ambrose, 2010. "Social Media as Public Expectation: The New Public Utility," available at https://www.nypl.org/blog/2010/06/30/social-media-public-expectation.

9 The social *cost* of operating two 25 percent networks might be more or less than one 50 percent network, but now the analysis has returned to the cost side and is essentially like the classic utility question.

10 Of course, the cost to you of dealing with two platforms might be greater than dealing with just one, so you might still prefer one 50 percent network to two 25 percent networks. But the gross value to you in terms of "widget sales" would not be different.

11 We are abstracting from potentially illegal conduct that could be undertaken by the one large provider.

12 While not the subject of this note, this same consideration should be at the center of the debate on whether large platforms should be forcibly broken up or not.

13 See David S. Evans & Richard Schmalensee, 2010. "Failure to Launch: Critical Mass in Platform Businesses, *Review of Network Economics* 9(4):1-1.

14 An exception to this would be the case of an entrant which is much more efficient and could better endure a price war with the incumbent.

There is likely some truth to this line of argument, meaning some large platforms are probably protected by barriers to entry, at least to some extent, and therefore enjoy some level of "market power." And it may be the case that certain platform services are best delivered by one large platform rather than multiple smaller platforms. Does this necessarily mean that they should be regulated as utilities? Here comes the economist's answer: maybe yes, but maybe no.

V. PLATFORMS AND INNOVATION

One important (if fairly obvious) difference between modern, internet-based platforms and classic public utilities is the room for innovation. Platform services are changing all the time, but electrons are electrons, and water is water.

For traditional public utilities it is somewhat difficult to imagine innovation which would qualitatively change the product being supplied. Yes, another company might have better customer service, or better maintenance practices, or better service restoration capabilities. But most of us, most of the time, do not need these things: we flip on the switch, and if the light turns on, we're satisfied.[15]

Internet platforms are obviously of a different nature. We expect innovation and change, and few of us would dare guess at what tomorrow's platforms may look like. Even fewer of us would expect that public regulatory authorities would be anywhere nearly as effective at providing such innovation.

In this context, economists refer to the tension between "static" and "dynamic" efficiencies. Static efficiency refers to the optimal way to arrange resources as they exist today, and dynamic efficiency refers to the optimal way to arrange resources over time. These considerations sometimes conflict with each other.

When we consider the (static) set of platforms as they exist today, a case could be made that social efficiency could be enhanced by some form of price-setting regulatory control.[16] But when we consider the (dynamic) set of possible future platforms, a case could be made that imposing such control today would stifle future innovation and hence future social efficiency. To many, the loss of innovation in the future is too great a cost to pay to have less expensive platforms today, especially when, to many consumers, platforms appear free already.[17]

VI. COMPETITION ON QUALITY AND PRICE

The power company is an example of a monopolist whose advantage is its production cost. The platform is an example of a monopolist whose advantage is its product quality. An entrant could attempt to compete on price, quality, or both. How could we handicap those strategies?

Faced with an incumbent who can produce widgets at lower cost than you can, your only hope of being successful is to compete on quality – to make a better widget. The incumbent's widget may always be cheaper because of its economies of scale, so yours must be better. The classic natural monopoly model essentially precludes the possibility that an entrant could successfully compete on price.

But in the case of modern platforms, faced with an incumbent who already supplies a larger network, an entrant has room to compete on both quality and price. Perhaps the entrant has figured out a way to provide services at lower cost; the incumbent's network may be larger, but if the entrant is sufficiently less expensive, subscribers may nevertheless choose to switch. Actual experience is more typically characterized by an entrant who has an innovation which allows subscribers to extract greater value from the network. The real difference between Uber and the traditional taxi model is the software which allows subscribers (passengers and drivers) to more efficiently and reliably extract value from what was, at least initially, a smaller network of passengers and drivers. In the taxi model, passengers find drivers by standing on street corners, waving their hands, and waiting, while drivers find passengers by driving around looking for them. In the Uber model, passengers and drivers find each other through an app which matches them by proximity and availability.

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15 There is certainly one area where we can imagine innovation which could be of material importance to consumers, and that relates to the cleanliness or "greenness" of the energy production itself. Some consumers might be willing to pay more for electricity generated by renewable or otherwise cleaner methods. But this is widely understood, and there is, at least in many places, substantial political pressure to adopt such technologies already. It is not obvious that, from a social welfare perspective, there is insufficient pressure from that direction.

16 Where there is a "network externality" it would generally be the case that private management of a network leads to under-utilization of that network relative to a hypothetical social ideal. Of course, to achieve the hypothetical social ideal might require that network utilization be subsidized – that prices be set below costs. Only a regulatory authority could achieve that.

17 From a social perspective, we cannot ignore the advertisers who may be paying super-competitive prices for internet ads.

Here again the question of "innovation" is central. If the industry is mature and we can't imagine much scope to innovate on the nature of the product (we can't imagine "better electrons" or "better water") then we can't imagine much scope for an entrant to be successful against the classic natural monopoly model. This means that the incumbent is more likely to be able to use its market power, which strengthens the regulatory argument. But where we can imagine improved products, then an innovative entrant has at least a chance of unseating an entrenched incumbent. We've seen this happen time and again: recall the examples of Blackberry and Windows in smartphone operating systems, AOL in messaging, Orkut in social networking, and Yahoo in mass online media, among others. This suggests that, at least in some cases, the incumbent's effective market power is limited.

VII. MULTI-HOMING AND SUCCESSFUL ENTRY

Arguably the most important difference between some platforms and the classic "natural monopoly" model is the possibility of multi-homing. Multi-homing refers to the phenomenon of subscribing to multiple platforms which provide essentially the same type of networking service. One provider may have 50 percent of the potential network as subscribers, but another provider may have a (different) 20 percent. It may make sense for a subscriber to use both and thereby have access to 70 percent of the potential network.

Multi-homing is unique to networks. We would not imagine homeowners simultaneously purchasing electricity from two providers for instance – if they had a choice, they would pick the cheaper one and purchase all their electricity from it. People may split their shopping across multiple grocery stores but that is to obtain different things at different places; people do not buy half their pre-planned weekly apples in one store and then half their weekly apples in another store. But with networks, it may make sense to use multiple providers to access a larger aggregate network.

What is critical in the multi-homing decision is that for those who already subscribe to the incumbent platform, its pricing is wholly irrelevant to the decision of whether to multi-home or not. Short of establishing exclusivity agreements with its subscribers (which some platforms do), there is in fact nothing the incumbent platform can do to influence the decision to multi-home among its current subscribers. It's entirely a matter of the size and price of the entrant's (unique) network.

Without multi-homing, the value proposition of an entrant must be, "stop using the incumbent and start using me" – in other words, to switch platforms. That, as we have seen, can be a very difficult proposition to make if the incumbent enjoys either economies of scale or strong network effects (or both). However, with multi-homing, the entrant merely needs to offer enough value to induce subscribers to *also* use its new platform, while still being able to continue subscribing to the incumbent's – in other words, to join, not necessarily to switch. Where network effects are stronger, inducing switching is more difficult, but inducing multi-homing is easier.

Multihoming is the key that unlocks the door. Suppose that initially, the incumbent has 50 percent of the potential market subscribed and an entrant has managed to get a different 20 percent to subscribe. Suppose the entrant's price is very low (perhaps even negative) so that half the incumbent's subscribers decide to also join the entrant's platform. Their decision is based on whether the cost of joining the entrant is less than the benefit of accessing an aggregate 70 percent network instead of just the 50 percent they already have. The stronger the network effect, the more valuable that incremental network size will be.

Now, the incumbent still has 50 percent, but the entrant has 45 percent (its original 20 percent base plus the 25 percent from the incumbent who have chosen to multi-home). The entrant begins to look more attractive to the remaining unsubscribed pool, and the proposition of outright switching to the entrant becomes more palatable to the incumbent's subscribers. The incumbent might fight back with lower prices, but if the entrant has something unique to offer, it may be able to win out, or at least carve out a niche and survive.

Forthcoming research models the competitive dynamics between two network providers.[18] Whether an entrant can overwhelm an incumbent depends on a number of factors (particularly the strength of the network effects), but when multi-homing is allowed, it substantially improves the entrant's chances of surviving and even dominating the incumbent.

18 Rosa Abrantes-Metz & Albert Metz, "Network Effects, Single- vs. Multi-Homing, and Consequences for Competition, Antitrust and Regulation," and "Two-Sided Platforms: Market Power, Indirect Network Effects, and Cross Platform Subsidies," *Working Papers*, August and September 2020, forthcoming.

VIII. MUST THERE BE ONLY ONE?

When we think of utilities, we usually think of a single provider supplying a given market. There are reasons why that may be sensible in the classic model, but those reasons may not apply to platforms.

With economies of scale, it can be socially optimal to have a single provider, so long as the price is controlled. If costs are falling it is less expensive to have one provider produce all 200 widgets rather than having two providers produce 100 each. Having one electric company rather than two is not just easier for the regulator to manage, it is actually the right answer.

As we have seen, whether that is true for a network depends on the strength of the network effects. With convex network effects it is likely true, but with concave effects it may not be. Hence, the regulatory problem is potentially more complicated with platforms: the regulator would need to determine not only pricing, but also the optimal allocation of subscribers across multiple networks. That is not a problem they face with the electric company.

IX. FINAL REMARKS

The basic economic argument for utility-like regulation of internet platforms is that when network effects are strong, these platforms become "natural monopolies" which tend to forestall competition. This at least suggests that they should be subject to similar controls as the local electric company or the phone company of yesteryear. But there are reasons to be cautious.

Innovation continues apace for many internet platforms. Not only does this make a quality-based barrier to entry easier to overcome, but it also highlights the risk that over-regulation may stifle welfare-enhancing future developments. The unique power of multi-homing further facilitates entry and represents a significant difference between at least some platforms and traditional monopolies.

This isn't just theoretical; we've seen entrants overcome and overwhelm entrenched incumbents time and time again. While this sort of churn doesn't obviate all antitrust concerns, it at least reminds us that the case of platforms is more complex and nuanced than that of the electric company.

At some point, perhaps, the network advantages of the current titans may become too great and the scope of innovation too narrow for any entrant to get a foothold. We do not mean to suggest that utility-style regulations are necessarily inappropriate as a way to regulate platforms today, and even less that they would always remain inappropriate tomorrow. Things change. But there is a risk that policy makers may act precipitously and regulate away the incentives for the kind of innovation which has so greatly enriched us all. That would be a terrible loss.

THE NEW TENTACLE OF EU COMPETITION LAW: TOOLS TO CONTROL FOREIGN-SUBSIDISED ACQUISITIONS AND MARKET DISTORTIONS

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I. THE SPONGE AND THE JELLYFISH

For those of us who have more grey hairs than we would like, EU competition law seems rather different today to what it was like when we started our journey. And the pace of change in the last few years seems to be faster than ever before.

Antitrust can be viewed as a sponge, as it picks up and is influenced by other disciplines, by ideas from other fields and by events.[2] This is to be expected given competition law reflects the political decision on how society decides to shape its economy. What is unusual in the last few years is how many new ideas and new influences there have been. This may be due to the stresses in the economy in the past decade since the global financial crisis as well as the rapid advance of technology.

We've seen hipster antitrust.[3] We've seen fairness being increasingly cited as a concept/goal.[4] We've seen the goal of curing wealth inequality as a new concept/goal.[5] We've seen antitrust get very close to other areas of regulation, including pharmaceutical regulatory law[6] and most recently data protection/privacy.[7] We've seen sustainability and environmental law be cited as goals of antitrust.[8] And, of course, very recently, we've seen antitrust authorities tweak their approaches and make new rules to adapt to the changed economic situation caused by the COVID-19 health crisis.[9]

But antitrust is not just a sponge, picking up ideas from elsewhere. It is also like a jellyfish. It can grow new tentacles, which can sting. We have seen many new tools being proposed in recent years. Indeed, two were proposed by the European Commission in the last month alone!

The first is the new "market investigation tool,"[10] which was put forward on June 2, 2020. It would give the Commission new powers to initiate market investigations without any prior finding, and independent of, any infringement of the competition rules. It would allow the Commission to impose behavioural or structural remedies unilaterally to address any structural competition problems that it uncovered. From *ex post* competition enforcement, the EU would move to an environment combining *ex post* and *ex ante* tools. While this tool would be novel in Brussels, some other countries do have similar tools like the UK, Greece, Israel, and Mexico.

Remarkably, this radical initiative is already old news! There has been another new tool proposed in the last month. It is different, but also potentially equally radical. It aims to counter the effects of foreign subsidies on the EU internal market and thus fill a gap between antitrust (merger control and State aids), foreign direct investment rules, public procurement rules, and trade defence instruments.[11]

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2 Ariel Ezrachi, "Sponge," (2017) 5(1) JAE 49, 50.

3 See, e.g. Marco Botta & Silvia Solidoro, "Hipster Antitrust, the European Way?," (2020) EUI - Robert Schuman Centre for Advanced Studies Policy Brief 1; Adi Ayal, "The Market for Bigness: Economic Power and Competition Agencies' Duty to Curtail it," (2013) 1 JAE 221. For a critical account on this concept see, e.g. Joshua D. Wright *et al.*, "Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust," (2019) 51 Arizona State Law Journal 293.

4 See, e.g. Damien Gerard, Assimakis Komninos & Denis Waelbroeck (eds), *Fairness in EU Competition Policy: Significance and Implications* (Larcier/Bruylant 2020); Sandra Marco Colino, "The Antitrust "F" Word: Fairness Considerations in Competition Law," (2019) 5 Journal of Business Law 329; Ariel Ezrachi & Maurice E Stucke, "The fight over antitrust's soul," (2017) 9 JECLP 1; Edwin J. Hughes, "The Left Side of Antitrust: What Fairness Means and Why it Matters," (2009) 77 Marq L Rev 265, 282-283; John B. Kirkwood & Robert Lande, "The Fundamental Goal of Antitrust: Protecting Consumers not Increasing Efficiency," (2008) 84 Notre Dame LRev 191.

5 See, e.g. Lina A. Khan, "The New Brandeis Movement: America's Antimonopoly Debate," (2018) 9 ECLP 131, 131; Lina A. Khan & Sandeep Vaheesan, "Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents," (2017) 11 Harvard Law & Policy Review 235. See also Florian Kraffert, "Should EU competition law move towards a Neo-Brandeis approach?," (2020) 16 European Competition Journal 55.

6 See, e.g. Case C-457/10 P, *AstraZeneca v. Commission*, ECLI:EU:C:2012:770.

7 Federal Cartel Office, Decision of February 6, 2019 in B6-22/16 – *Facebook*, available at https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Missbrauchsaufsicht/2019/B6-22-16.pdf?__blob=publicationFile&v=8.

8 See, e.g. Maurits Dolmans, "Sustainable Competition Policy," (March 22, 2020, CLPD), available at https://ssrn.com/abstract=3608023.

9 See, e.g. Commission Implementing Regulation (EU) 2020/593 of 30 April 2020 authorising agreements and decisions on market stabilisation measures in the potatoes sector [2020] OJ L140/13. There were pushes for price regulation in the COVID-19 context too, e.g. French Ministry for the Economy, Directorate General for Competition, Consumption and Anti-Fraud Action, "Control of prices for hydroalcoholic gels – FAQs," (March 11, 2020), available at https://www.economie.gouv.fr/dgccrf/encadrement-des-prix-pour-les-gels-hydroalcooliquesvoir-la-faq.

10 For which the Commission opened a public consultation on June 2, 2020. See European Commission, "Antitrust: Commission consults stakeholders on a possible new competition tool," (June 2, 2020), available at https://ec.europa.eu/commission/presscorner/detail/en/ip_20_977.

11 For the non-trade lawyer, this typically covers anti-dumping, countervailing duty and safeguard cases, which are all permitted under (and to an extent governed by) WTO law.

The announcement of the new tool was made by a Commission White Paper called "Levelling the Playing Field with regards to Foreign Subsidies," published on June 17, 2020 ("White Paper").[12] The White Paper proposes three new tools to control the acquisitions and activities of foreign subsidised companies in the EU: (i) a general *ex post* control mechanism to review competitive distortions, (ii) a mandatory *ex ante* notification mechanism that would allow the Commission to review foreign subsidised acquisitions, including certain minority investments, and (iii) the possibility to exclude bidders that have received distortive foreign subsidies from public contracts tendered by the EU and Member State authorities.

This paper will look at what the new tool includes and then offer one or two concluding thoughts on whether there are limits to where competition law should tread. This new tool, like the new market investigation tool, is just a proposal at this stage – and its scope is likely to be clarified during the legislative process.

II. WHY ANOTHER NEW TOOL?

The Commission already has a range of powers to tackle subsidies, both home-grown and international: it can apply EU competition law and the WTO trade rules. In addition, it recently acquired powers to ensure the protection of certain strategic EU assets from foreign investors from a national security or public order perspective.

The reason for the new tool, according to the Commission, is that these instruments leave an enforcement gap,[13] both when it comes to the review of acquisitions of EU companies by subsidised non-EU companies, and for the distortive effects of certain foreign subsidies on the internal market.

First, as the White Paper notes, neither EU antitrust rules nor EU merger control regulations "*specifically take into account whether an economic operator may have benefited from foreign subsidies (even if in principle it could form part of the assessment) and they do not allow the Commission (or Member States) to intervene and decide solely or even mainly on this basis*."[14]

Second, the White Paper notes that financial support granted by third countries (either to undertakings active in the EU or to their parent companies outside the EU) is not covered by EU State aid rules.[15]

Third, under national FDI screening mechanisms and the EU FDI Screening Regulation,[16] authorities may assess and block FDI based on security and public order grounds, but this does not explicitly include considerations of foreign state subsidies.[17]

Finally, EU anti-dumping and anti-subsidy rules, themselves based on WTO Agreements, apply to the import into the EU of goods only, and – importantly – do not cover trade in services, acquisitions of EU companies or other financial flows in relation to the activities of undertakings in the EU. It is also difficult to apply anti-subsidy duties to subsidies granted by Country A, which benefit a company that is exporting to the EU from a factory located in Country B – although the EU has recently adopted measures on this basis in rather specific circumstances.[18]

It is this enforcement gap relating to the distortive impact of foreign subsidies on the EU's internal market, which lies between the boundaries of traditional competition and trade rules, that the White Paper is proposing to close.

12 European Commission, "White Paper on levelling the playing field as regards foreign subsidies," (June 17, 2020), available at https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf ("White Paper").

13 White Paper (op. cit.) p. 9.

14 *Ibid.*

15 *Ibid.*

16 Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union [2019] OJ L79I/1.

17 White Paper (op. cit.) p. 10.

18 The recently concluded anti-subsidy investigation into imports of Glass Fibre Reinforcements from Egypt is a rare case in this direction: indirect Chinese subsidies (preferential financing) given to companies in the China-Egypt Suez Economic and Trade Cooperation Zone were attributable to Egypt because the latter had recognized and endorsed the preferential financial support of the Chinese authorities and adopted it as its own. See Commission Implementing regulation (EU) 2020/776 of 12 June 2020 imposing definitive countervailing duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People's Republic of China and Egypt and amending Commission Implementing Regulation (EU) 2020/492 imposing definitive anti-dumping duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People's Republic of China and Egypt [2020] OJ L 189/1, paras 676-699 and 706-725.

III. THREE PROPOSED "MODULES" TO EXPAND THE EU'S COMPETITION RULES

In order to address potential distortions on the EU market, the Commission proposes three approaches, which can be applied in parallel.

A. Module 1: Addressing distortions caused by foreign subsidies given to an economic operator active in the EU market

With this first tool, the Commission envisages making an *ex post* review of the impact on the EU internal market of foreign subsidies granted to any company active in the EU, irrespective of its place of establishment. Such review would generally be initiated *ex officio* by the Commission or a national authority: they "*may act upon any elements* [they consider] *relevant indicating the granting of a foreign subsidy to a beneficiary active in the EU*.'[19] Both the Commission and Member States could conduct this review, with Member States having competence where the foreign subsidy impacts one Member State.

In a two-step review process to determine the impact of specific subsidies on the internal market, the authorities would consider indicators such as: the size of the subsidy, the situation, market conduct and level of activity of the beneficiary on the internal market and the general situation of the market concerned.

The White Paper envisages that certain categories of subsidies (e.g. subsidies in the form of export financing) are likely to create distortions in the internal market because of their nature and form. Even if a distortion is established, it could be balanced by a positive impact: for example, the subsidy may support the EU's own public policy objectives (e.g. creating jobs, environmental considerations, digital transformation, or public safety).[20] Interestingly, these public policy justifications are often not available in EU anti-subsidy investigations in the trade defence, so their inclusion here does show that this is a hybrid form of instrument between trade and competition. As a result, economic operators need to be prepared to present a convincing strategy in light of the Commission's concerns.

If the Commission remains unconvinced, it has the possibility to impose so called "redressive measures," including structural remedies (e.g. divestments), behavioural measures (e.g. prohibition of certain investments, acquisitions or market conduct; third-party access; FRAND licensing) and redressive payments to the EU or Member States.[21] In addition, the EU authorities may impose severe sanctions for not supplying information or supplying incomplete, incorrect or misleading information, while also undertaking fact-finding visits at the EU premises of the alleged beneficiary of a foreign subsidy.

One other interesting import (evidence of the sponge at play) is the idea that if information is not provided then cases would be decided based on "facts available." For those of us who are familiar with trade defence instruments, and especially how the U.S. authorities use Adverse Facts Available in anti-dumping cases,[22] this seemingly small rule change could have important consequences for how competition law develops.

B. Module 2: Tackling the distortive effect of foreign subsidies facilitating the acquisition of EU targets

Under its second tool (which can be used cumulatively with the first one or on its own), the Commission proposes an *ex ante* review, based on a mandatory notification, of acquisitions of EU undertakings that have been facilitated by foreign subsidies. This is not only limited to direct subsidies that are linked to the acquisition, but also covers indirect subsidies that *de facto* increase the financial strength of the acquirer, which would then be used for an acquisition, and may give rise to a distortion of the internal market. As a result, this is a potentially extremely broad tool.

The new measures would cover not only acquisitions of control of an undertaking, but also acquisitions above a certain percentage of the shares or voting rights (threshold yet to be determined) or any "material influence" over an undertaking (precise concept yet to be determined). Therefore, the Commission could also target certain acquisitions of non-controlling minority shareholdings.

Needless to say, as the rules pass through the legislative process we would expect guidance to be adopted as to what "material influence" would cover, particularly as the regime will be mandatory and not voluntary. On the one hand, the "material influence" test may be similar to the

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19 White Paper (op. cit.) p. 13.

20 White Paper (op. cit.) p. 17.

21 White Paper (op. cit.) p. 19.

22 See, e.g. in *Polyethylene Terephthalate Resin From Pakistan*, Final Determination of Sales at Less Than Fair Value, 83 Fed. Reg. 48,281 (U.S. Dep't Commerce, September 24, 2018).

one used by the UK Competition and Markets Authority to capture acquisitions in which, even though de facto or de jure control is not reached, the acquirer is deemed to have material influence over the target by other means, such as relevant industry expertise that may influence decisions at the shareholder or board level. On the other hand, it could well also resemble the German "competitively significant influence" test.

The Commission recommends that only potentially subsidised acquisitions of EU targets, i.e. where the notifying parties have received a financial contribution by any third-country authority in the past three years, or expect such contribution in the coming year, would trigger a notification requirement requiring the transaction to be put on hold. It proposes to define an EU target as "*any undertaking established in the EU and meeting a certain turnover threshold in the EU, but other criteria could also be considered*" and then indicates that the turnover threshold "*could be set at for example EUR 100 million, but other values, thresholds or alternative approaches could also be envisaged.*"[23]

Moreover, the notification requirement would be triggered where the financial contribution received by the acquiring undertaking in the three calendar years prior to the notification is in excess of a certain amount or of a given percentage of the acquisition price.[24] Being a triggering event, these criteria need to be clearly defined. As anyone who is familiar with anti-subsidy or State aid investigations would tell you, establishing the amount of the financial contribution with precision is not an easy task. This may potentially lead the threshold for financial contribution to be relatively low – which would allow authorities and companies to proceed on the basis that the threshold is met without having to first undertake a detailed analysis of the exact value of the potential financial contribution (which is a task that typically takes many months in trade cases). This being said, the fact that the approach to determining notifiable acquisitions relies on self-assessment, including as to past subsidy received, does increase legal uncertainty.

Similar to Module 1, the effects of the subsidy may be balanced against the overall positive impact of the transaction. If, however, the Commission finds a distortion, it may adopt a conditional clearance decision based on proposed commitments, or prohibit the proposed transaction. Again, the Commission envisages a sanction mechanism for violations of procedural rules, such as on the submission of incorrect or misleading information.[25]

Potentially, this new tool would lead to a significant number of transactions becoming notifiable on top of existing merger control and FDI rules. Clearly, efficient procedures and clear guidance would need to be put in place to avoid unnecessary red tape for foreign investment.

C. Module 3: Tackling distortive foreign subsidies in public procurement rules

Finally, the Commission proposes adjustments to EU public procurement rules, which would require bidders to notify contracting authorities whether they have received any foreign subsidy in the previous three years, or would receive such a contribution in the course of the contract. Such information would then be passed to the competent supervisory authority, which may start an investigation. If it is found that the bidder has received a distortive foreign subsidy, then the operator may be excluded from the specific tender process or even from all future public procurement procedures up to three years.[26]

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23 White Paper (op. cit.) p. 25.

24 *Ibid.*

25 White Paper (op. cit.) p. 28.

26 White Paper (op. cit.) pp. 30-31.

IV. DOUBLE TROUBLE? HOW WILL THE NEW TOOL INTERPLAY WITH OTHER EU RULES?

Competition law's new tentacle is emerging in a busy part of the sea – there are many other regulations in this space. How will they all work together?

The White Paper notes that since the objective of the new tools is different from that of existing tools – focusing on the effects of foreign subsidies as such – the new tools are complementary to EU merger control and EU antitrust rules. In a situation where a transaction would have to be notified under both Module 2 and the EU Merger Regulation (or national merger control regulations), there would be parallel proceedings (albeit the review period for the Module 2 procedure has not yet been determined). The Commission notes that:

> "*while subsidies may be taken into account when assessing for instance the financial strength of the merged entity relative to its rivals, the focus of the analysis of the significant impediment to effective competition is on the structure of competition in a given market, not on the existence or effects of foreign subsidies as such. A new instrument would therefore with its different objective complement the Merger Regulation. If a given acquisition has to be notified under both such a new instrument and the Merger Regulation, the notification and possible assessment would be dealt with in parallel, but separately from each other under the respective instruments.*"[27]

Similarly, the Commission considers the new tools to be complementary to EU trade defence instruments and WTO Agreements. It notes that the new tools would not cover the subsidised import of goods from third countries to the EU, but only the subsidisation of an undertaking active in the EU (other than through trade in goods from the subsidising country) and the subsidised acquisition of an EU target.

The Commission also regards the new tools to be complementary to the FDI screening mechanisms which come into effect in October 2020.[28] While the FDI Screening Regulation is limited to soft harmonization of the assessment of threats to public security and public (i.e. critical or strategic) assets, and to introducing a cooperation mechanism between the Commission and the Member States, the newly proposed instrument would assess potential distortions in the internal market more broadly, without any limitation on the type of assets. Moreover, while the FDI Screening Regulation targets all types of FDI, the trigger for a review under the newly proposed tools is foreign subsidies that may or may not be linked to an investment. However, overlaps will exist if an FDI constitutes an acquisition that is facilitated by a foreign subsidy, but which also raises concerns with regard to security and public order.

Overall, there will clearly need to be a lot of work on the procedures to make them efficient given the other parallel competences, which are closely related to this new tool.

V. NEXT STEPS FOR THE NEW FOREIGN SUBSIDIES TOOL

As the latest new tentacle of the competition law jellyfish, the White Paper is far-reaching and will add a new dimension to competition law enforcement. Indeed, if adopted into legislation, these tools would have significant implications for companies operating in the EU that receive some form of foreign subsidy, or acquisitions of EU companies financed by foreign subsidies.

At the moment, the White Paper only reflects a policy proposal (on which comments are invited by September 23, 2020). It is likely to be the subject of significant debate during the legislative process between the European Parliament and the Council. That debate will have to balance different interests: some EU governments need and want foreign investments, while others are concerned about the ability of subsidies to distort the playing field. It is likely to take two years for the White Paper to become law, depending on the degree of consensus among the different institutions. The Commission's proposals will no doubt be subject to debate and clarification/amendments along the way.

The devil will be in the detail here. The Commission's proposal will need to be clarified on a number of issues, which will be crucial to how they will work in practice. For example, the definition of "material influence," plus the level of financial contribution and size of the transaction caught by the new rules, will determine how many mandatory *ex ante* notifications will be made.

27 White Paper (op. cit.) p. 40.

28 White Paper (op. cit.) p. 43.

VI. CONCLUSIONS ON THE SPONGE AND THE JELLYFISH

There is a risk that when competition law goes beyond its core area it will lose its coherence and that its core principles will become diluted or difficult to distinguish. This applies whether we're talking about the sponge (e.g. using competition law to tackle environmental sustainability, privacy, fairness or just because we want to be hipster) or the jellyfish (with new tentacles like the one explored above tacking foreign subsidies). Without entering too deeply into that debate in this short article, it is clear that this risk has never been greater given the number of different new, innovative, and often radical tools and ideas/policy goals being considered.

The foreign subsidies White Paper possibly carries less risk of diluting core competition law principles than some of the other initiatives or ideas, in that it is *sui generis* in aiming to cover a perceived gap between a number of other sets of legal rules. However, it carries a different risk of overlap and inefficiency, which we could hope can be ironed out before the proposal becomes law.

IF IT AIN'T WORKING, FIX IT — WITH COMPETITION, NOT MONOPOLY

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I. INTRODUCTION

The ability of individuals to repair, maintain, or modify things they own is often referred to as the "right to repair." In response to pressure over the last decade contracting this right, an advocacy movement has gained traction in the United States as well as abroad. The movement "argues that companies should make it easier for their customers to fix their own stuff."[2] It also is critical of manufacturers who have created "repair monopolies" that force customers to have their things repaired exclusively by the manufacturer or its authorized agent. Proponents also highlight that repair monopolies increase consumer repair costs and encourage waste.

In one high profile example, farmers across the United States protested repair restrictions that John Deere placed on new tractors. By the terms of a claimed "license" agreement accompanying tractor purchases, John Deere forbids farmers from doing their own repairs and modifications to equipment and requires them, instead, to go to John Deere dealerships or other authorized repair shops for maintenance work.[3] Tech giants like Apple and Microsoft have similarly made it difficult for independent shops to repair consumer electronics products, requiring customers to go directly to the manufacturer or other authorized shops for repairs.[4]

While in recent years right to repair advocates have focused on products like these, repair monopolies also affect important healthcare products. The COVID-19 pandemic has revealed that products used to treat the virus are subject to repair restrictions that make shortages of critical product more dire. For instance, repair restrictions barred hospitals from fixing one of the most necessary medical devices needed to treat COVID-19 patients: ventilators.

In March 2020, healthcare systems across the country, including those in areas hit hard by COVID-19 like New York and Los Angeles, reported receiving many broken ventilators. Like John Deere tractors and consumer electronics products, ventilators are controlled by "software locks" that require manufacturer authorization before anyone can repair them.[5] Ventilator manufacturers refused to release design specifications that would allow hospitals to fix their own broken devices. To acquire manuals, manufacturers required technicians to be "certified" by them, and certifications programs are pricey, costing up to $7,000 for a single program.[6] The problem is amplified because hospitals can have ventilators made by different manufacturers, requiring technician certification from each company. And, just to maintain access to the manuals, hospitals need to pay multiple annual subscription fees.

In response to hospital complaints, right to repair advocates crowdsourced manuals online. Under pressure from these groups and politicians from several states, some manufacturers relented and made manuals available online,[7] or waived training requirements. GE Healthcare announced that it would provide access "temporarily" to its technical reference manual and PC service application for its ventilators without conditioning access on the otherwise required four days of in-person training.[8] The dispensations are not permanent, however.

Similarly, in Italy a hospital needed replacement valves for breathing devices used to treat COVID-19 patients.[9] The valves were not then available anywhere, and the manufacturer refused to provide the hospital with the technical 3D print files needed to produce the valves. Hospital doctors found a pharmaceutical worker with the necessary 3D printer, who also was able to reverse-engineer a 3D print design from scratch. He printed a batch of valves for the hospital free of charge. The cost: about €1 each — compared to the manufacturer's reported list price of €10,000. Perversely, IP and other repair restrictions stood in the way of continued production.

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2 Bryan Lufkin, "Right-to-repair movement," BBC (July 21, 2019), https://www.bbc.com/worklife/article/20190719-right-to-repair-movement.

3 Jason Koebler, "Why American Farmers are Hacking Their Tractors with Ukrainian Firmware," VICE (Mar. 21, 2017), https://www.vice.com/en_us/article/xykkkd/why-american-farmers-are-hacking-their-tractors-with-ukrainian-firmware.

4 Tik Root, "Apple effectively has a monopoly on fixing your iPhone. There's now a fight to change that." VOX (July 3, 2019), https://www.vox.com/the-goods/2019/7/3/18761691/right-to-repair-computers-phones-car-mechanics-apple.

5 Jason Koebler, "Hospitals Need to Repair Ventilators. Manufacturers Are Making That Impossible," VICE (Mar. 18, 2020), https://www.vice.com/en_us/article/wxekgx/hospitals-need-to-repair-ventilators-manufacturers-are-making-that-impossible.

6 Isaac Scher, "Hospitals need ventilators to keep severe COVID-19 patients alive. They might not be able to fix them without paying the manufacturer $7,000 per technician," Business Insider (June 3, 2020), https://www.businessinsider.com/ventilator-manufacturers-dont-let-hospitals-fix-coronavirus-right-to-repair-2020-5.

7 Matthew Gault, "Ventilator Companies Finally Make the Life Saving Devices Easier to Repair," VICE (Apr. 23, 2020), https://www.vice.com/en_us/article/884zvx/ventilator-companies-finally-make-the-life-saving-devices-easier-to-repair.

8 GE Healthcare, "COVID-19 Ventilator Support," https://services.gehealthcare.com/gehcstorefront/repair/VentilatorSupport.

9 Glyn Moody, "Volunteers 3D-Print Unobtainable $11,000 Valve For $1 To Keep Covid-19 Patients Alive; Original Manufacturer Threatens To Sue," Techdirt (Mar. 17, 2020), https://www.techdirt.com/articles/20200317/04381644114/volunteers-3d-print-unobtainable-11000-valve-1-to-keep-covid-19-patients-alive-original-manufacturer-threatens-to-sue.shtml; Jay Peters, "Volunteers produce 3D-printed valves for life-saving coronavirus treatments," The Verge (Mar 17, 2020), https://www.theverge.com/2020/3/17/21184308/coronavirus-italy-medical-3d-print-valves-treatments.

These COVID-19 examples drive home that protecting the right to repair is not simply a matter of consumer cost savings or environmental conservation, but, indeed, one with critical human health implications. Ideas of "ownership" — that bundle of rights that the law recognizes — are at the heart of the issue. With companies placing increasingly stricter repair monopolies on their products, it has become correspondingly more difficult for customers to exercise time-honored prerogatives of ownership. Customers of items they believe they have purchased meet manufacturer assertions that the items were "licensed." Insofar as the "license" view prevails, "owners" may be barred from doing what they want with their devices. Contrary to their expectation upon purchase, they may need "permission" from the manufacturer to fix, service, or improve their device.

By making it harder for an owner to fix her products, manufacturers encourage her to opt to replace them. The environmental impact of this induced obsolescence is dramatic:

> All that unfixable stuff doesn't disappear when we are forced to replace it. It piles up. Electronic waste is the fastest growing part of our waste stream. It is often toxic and poses grave health risks. The increase in this kind of waste is fed both by the growing number of products with electronics in them and the shrinking lifespan of those products.[10]

Sometimes, the "stuff" doesn't just pile up, but is, instead, shipped abroad to poorer countries.[11]

This article explores the ramifications of repair monopolies. We first overview the right to repair movement, and thereafter summarize its anchor in antitrust law. After that, we discuss the far-reaching effects of repair monopolies, including their risks to health and safety and their negative effects on innovation and social welfare.[12]

II. THE RIGHT TO REPAIR MOVEMENT CHALLENGES ANTI-CONSUMER RESTRICTIONS

The current right to repair movement has its roots in the response to restrictions on automobile repair, which developed about a decade ago. Following public support, in 2012 Massachusetts passed the first automotive right to repair bill. The legislation's popularity with consumers was evident, as the bill passed with 86 percent of voters approving the measure. Under the Massachusetts law, an automobile manufacturer must make available to owners and independent repair shops "the same diagnostic and repair information, including repair technical updates, that such manufacturer makes available to its dealers through the manufacturer's internet-based diagnostic and repair information system or other electronically accessible manufacturer's repair information system."[13] In 2014, various auto industry groups pledged support for the Automotive Right to Repair Memorandum of Understanding, a nationwide policy based on the Massachusetts law.[14]

Around this same time, advocacy groups, such as the Repair Association (formerly known as the Digital Right to Repair Coalition) and iFixit, began to promote right to repair legislation that extended beyond the automobile industry and into consumer electronics and other digital products. The groups' stated goals are representative of the right to repair movement. The Repair Association advocates for: (1) "equal access" to "the same diagnostics, information, and parts available to" dealers; (2) the public availability of service manuals and schematics; and (3) the availability of parts and tools at non-discriminatory prices.[15] iFixit advocates for the same policies. However, it has also posted online materials needed for individuals to repair their own broken devices. On its website, iFixit crowdsources and publishes manuals for different devices whose manufacturers do not provide them publicly. No good deed goes unpunished, of course: at least one manufacturer, Steris, has asserted that iFixit is infringing its copyright.[16]

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10 Nathan Proctor, "Right to Repair Is Now a National Issue," Wired (Apr. 1, 2019), https://www.wired.com/story/right-to-repair-elizabeth-warren-farmers/.

11 Editorial, "Warren and Sanders Say We Need a 'Right To Repair' Tractors. Here's Why That's Important," In These Times (Aug. 1, 2019), https://inthesetimes.com/article/21952/right-to-repair-technology-Apple-manufacturing.

12 See generally Daniel A. Hanley *et al.*, "Fixing America: Breaking Manufacturers' Aftermarket Monopoly and Restoring Consumers' Right to Repair," Open Market Institute (Apr. 13, 2020), https://www.openmarketsinstitute.org/publications/fixing-america-breaking-manufacturers-aftermarket-monopoly-restoring-consumers-right-repair.

13 Mass. Gen. Laws ch. 93K (2012); see generally Daniel Cadia, *Fix Me: Copyright, Antitrust, and the Restriction on Independent Repairs*, 52 U.C. Davis L. Rev. 1701, 1706 (2019).

14 *Id.*

15 The Repair Association, "Policy Objectives," available at http://repair.org/policy.

16 Kevin Truong, "A Medical Device Maker Threatens iFixit Over Ventilator Repair Project," Motherboard (June 16, 2020), https://www.vice.com/en_us/article/akze8j/a-medical-device-maker-threatens-ifixit-over-ventilator-repair-project.

In 2015, the Repair Association and other groups worked to introduce "Fair Repair" legislation in New York, Massachusetts, and Michigan, which would require electronics manufacturers to provide owners and independent repair businesses with access to service information, security updates, and replacement parts. By 2019, twenty states had bills related to the right to repair electronics, modeled on the Massachusetts automobile law.[17] Massachusetts is once again leading the legislative charge. In February 2020, the Digital Right to Repair Act moved out of committee in both the Massachusetts House and Senate, making it farther along than the bills pending in other states.[18] Under the bill, manufacturers of digital electronic products sold in the state must:

> (1) make available to independent repair facilities or owners of products manufactured by the manufacturer the same diagnostic and repair information, including repair technical updates, diagnostic software, service access passwords, updates and corrections to firmware, and related documentation, free of charge and in the same manner the manufacturer makes available to its authorized repair providers; and
>
> (2) make available for purchase by the product owner, or the authorized agent of the owner, such service parts, inclusive of any updates to the firmware of the parts, for purchase upon fair and reasonable terms.[19]

III. PROPOSED LEGISLATION IN OTHER STATES IS SIMILAR

At the national level, the Federal Trade Commission held a hearing on repair restrictions in mid-2019.[20] And, during their Democratic presidential nomination campaigns, Senators Sanders and Warren and former Colorado Governor Hickenlooper all called for federal legislation designed to protect the right to repair in the agricultural industry.[21] The Copyright Office opined in 2016 that, while software is embedded in many consumer products, "faithful application of existing copyright law doctrines *should* provide no barrier" to resale and repair, security research, and tinkering to permit interoperability.[22] The Office's opinion is nice. But as Steris' more recent infringement letter to iFixit demonstrates, legislation protecting these uses would be even better.

Right to repair activism is not confined to the United States. Earlier this year, the European Commission announced its intent to introduce a right to repair policy for electronic devices. The focus of the Commission's policy is a reduction of electronic waste by extending the lifespan of electronic products through repair and recycling of parts.[23]

Unsurprisingly, product manufacturers that have encumbered their items with repair monopolies have pushed back against legislative initiatives. For instance, Apple, Verizon, Toyota, Medtronic, and other large companies and trade organizations lobbied against a New York right to repair bill, paying lobbyists $366,634 between January and April 2017.[24] By comparison, the only group publicly lobbying in favor of the legislation spent just $5,042.[25] The bills' opponents do not always make public their reasons for opposition — no doubt to avoid coming across as anti-consumer — but when they do, they generally focus on nebulous concepts of safety and privacy. Speaking against a bill introduced in Nebraska, Apple told legislators that if the bill passed, Nebraska would become a "mecca for bad actors" and "that doing this would make it very

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17 "California Becomes 20th State in 2019 to Consider Right To Repair Bill," U.S. PIRG (March 18, 2019), https://uspirg.org/news/usp/california-becomes-20th-state-2019-consider-right-repair-bill.

18 Matthew Gault and Jason Koebler, "A Right to Repair Law Is Closer Than Ever," VICE (Feb. 5, 2020), https://www.vice.com/en_us/article/k7e7xm/a-right-to-repair-law-is-closer-than-ever.

19 H.B. 218 (Mass. 2019).

20 Federal Trade Commission, "Nixing the Fix: A Workshop on Repair Restrictions" (July 16, 2019), https://www.ftc.gov/news-events/events-calendar/nixing-fix-workshop-repair-restrictions.

21 Matthew Gault, "Bernie Sanders Calls for a National Right-to-Repair Law for Farmers," Motherboard (May 5, 2019), https://www.vice.com/en_us/article/8xzqmp/bernie-sanders-calls-for-a-national-right-to-repair-law-for-farmers.

22 U.S. Copyright Office, "Software-Enabled Consumer Products" ii (Dec. 2016) (emphasis added), https://www.copyright.gov/policy/software/software-full-report.pdf.

23 Natasha Lomas, "European lawmakers propose a 'right to repair' for mobiles and laptops," Tech Crunch (Mar. 11, 2020), https://techcrunch.com/2020/03/11/european-lawmakers-propose-a-right-to-repair-for-mobiles-and-laptops/.

24 Jason Koebler, "Apple Is Lobbying Against Your Right to Repair iPhones, New York State Records Confirm," VICE (May 18, 2017), https://www.vice.com/en_us/article/nz85y7/apple-is-lobbying-against-your-right-to-repair-iphones-new-york-state-records-confirm.

25 *Id.*

easy for hackers to relocate to Nebraska."[26] One cannot help but ask: what sort of firewall has Nebraska thrown up that requires out-of-state hackers to relocate in-state in order to ply their trade?

A director of the Security Innovation Center, a tech company coalition opposing right to repair bills, has similarly said that "tinkerers and amateur repairers could expose devices to hacks that might divulge personal information or increase the risk of fires."[27] John Deere has stated that it "supports the right to repair but not the right to modify" because "[a]llowing untrained individuals to modify equipment software can endanger operators, bystanders, dealers, mechanics, customers, and others and may result in equipment that no longer complies with industry and safety standards or environmental regulations."[28] One can search their opposition in vain, however, for specifics to back up this parade of horribles.

Right to repair advocates have typically casted off these remarks as pretextual. As one right to repair group has said in its statement of principles:

Arguments that seek to conceal the workings of a product in the name of security so as to undermine the rights of owners or their agents to service, repair or modify their property are *prima facie* false and should be rejected as such. True, verifiable security is the product of secure design and thorough testing and improvement, not secrecy.[29]

A policy analyst for Consumers Union has similarly pointed out that there was no uptick in safety problems attributed to passage of the Massachusetts automobile bill.[30] Automobiles certainly seem to present more safety concerns than do iPhones or computers.

But if these anti-repair companies had disclosed their real basis for opposition — creating or maintaining lucrative repair monopolies — their objections would likely not have been so successful.

26 Jason Koebler, "Apple Tells Lawmaker that Right to Repair iPhones Will Turn Nebraska Into a 'Mecca' for Hackers," VICE (Feb. 17, 2017), https://www.vice.com/en_us/article/pgxgpg/apple-tells-lawmaker-that-right-to-repair-iphones-will-turn-nebraska-into-a-mecca-for-hackers.

27 Elaine S. Povich, Tech Giants Fight Digital Right-to-Repair Bills, PEW (Oct. 16, 2019), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2019/10/16/tech-giants-fight-digital-right-to-repair-bills.

28 *Id.*

29 SecuRepair, "Statement of Principles," available at https://securepairs.org/statement-of-principles/.

30 Povich, *supra* note 27.

IV. REPAIR MONOPOLIES INTERSECT THE ANTITRUST LAWS: IMPAIRMENT OF COMPETITION

Although the right to repair controversy has emerged from the recent generation of electronic products and the software that runs and interacts with them, its seeds were planted much earlier — back at the time that IBM dominated the market for early-generation computers. In 1956, IBM entered into an Antitrust Division consent decree directed in part to stimulating competition in the market for *used* IBM machines. Because used machines "would not be attractive to own unless good service was obtainable at reasonable price,"[31] the decree ordered IBM:

> to offer to sell at reasonable and nondiscriminatory prices and terms, to owners of IBM . . . machines (whether or not the purchaser receives IBM repair and maintenance service) and to persons engaged in the business of maintaining and repairing such machines . . . repair and replacement parts and subassemblies for any . . . machines manufactured by IBM."[32]

Consistent with the goal of contemporary right to repair advocates, this decree provision "was intended to 'establish an independent repair and maintenance service industry' and to ensure that purchasers of IBM machines would have access to 'necessary repair and maintenance service and replacement parts and sub-assemblies until alternate sources for such repair and maintenance and replacement parts [became] established."[33] The IBM decree operated for 40 years, until 1996, when, after industry changes, the company and the Antitrust Division agreed to phase out the remedy.[34]

A few years before the IBM decree ended, the Supreme Court examined a different repair monopoly in Eastman *Kodak Co. v. Image Tech. Servs., Inc.*[35] At the time, Kodak provided 80-95 percent of the service for its own copying and micrographic equipment.[36] The remainder was performed by independent service organizations ("ISOs") at lower prices than Kodak charged.[37] Beginning in 1985, Kodak adopted a policy of selling replacement parts for its machines only to buyers of Kodak equipment who also used Kodak services, thereby impairing the ISOs' ability to compete with Kodak in the market for servicing the company's machines.[38] Eighteen ISOs sued Kodak under the Sherman Act, alleging that "Kodak had unlawfully tied the sale of service for Kodak machines to the sale of parts . . . and had unlawfully monopolized and attempted to monopolize the sale of service for Kodak machines . . . ."[39]

The Ninth Circuit denied Kodak's motion for summary judgment, and the Supreme Court affirmed. Regarding the tying claim, the Court held that a reasonable trier of fact could find that service for Kodak's machines and the parts for the machines were two distinct products, and that Kodak had tied their sale: "Kodak would sell parts to third parties only if they agreed not to buy service from ISOs."[40] To succeed on a tying claim, however, the ISOs also had to show that Kodak had "appreciable economic power in the tying market" — here, the product parts market, available to customers only if they used Kodak services (the "tied" product).[41] The Supreme Court found it "reasonable to infer that Kodak has market power to raise prices and drive out competition in the aftermarkets, since [the ISOs] offer direct evidence that Kodak did so."[42]

On the monopolization claims, the ISOs presented genuine issues of fact whether Kodak monopolized, or attempted to monopolize, the service and parts markets. Kodak's control of "nearly 100% of the parts market and 80% to 95% of the service market" sufficed to establish

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31 Peter Passell, "I.B.M. and the Limits of a Consent Decree," The New York Times (June 9, 1994), https://www.nytimes.com/1994/06/09/business/ibm-and-the-limits-of-a-consent-decree.html.

32 Consent Decree, Section VI, *United States of America v. International Business Machines Corp.*, No. 72-344 (S.D.N.Y. Jan. 25, 1956).

33 Public Comment of Independent Service Network International on the Parties' Proposed Modifications to the Consent Decree, *United States of America v. International Business Machines Corp.*, No. 72-344 (S.D.N.Y. Sept. 30, 1996) (quoting statements from IBM at January 25, 1956 hearing on consent decree), 1996 WL 33671059.

34 Bart Ziegler, "IBM Reaches Settlement To End Consent Decree," The Wall Street Journal (July 3, 1996), https://www.wsj.com/articles/SB836341174520145000.

35 504 U.S. 451(1992).

36 *Id.* at 457.

37 *Id.*

38 *Id.* at 458.

39 *Id.* at 459.

40 *Id.* at 463.

41 *Id.* at 464.

42 *Id.* at 477.

market power.[43] That the relevant products — service and parts — both came from a single brand, Kodak, was not determinative. Additionally, evidence further showed that to maintain its monopolies, Kodak excluded the ISOs from both markets. Kodak offered business justifications for its exclusionary conduct, including that its actions were designed to maintain high quality servicing.[44] However, the Supreme Court held that record evidence supported a conclusion that Kodak's justifications were pretextual. On remand, the case was tried by a jury, which returned a verdict for the ISOs, who were awarded damages and an injunction. The Ninth Circuit affirmed in substantial part.[45]

Decades after *Eastman Kodak*, in *Red Lion Safety, Inc. v. General Electric Company*,[46] ISOs who provided service, maintenance, and repair for GE gas anesthesia equipment sued GE for unlawful monopolization.[47] First, the ISOs alleged that, by designating a single distributor of replacement parts, GE unlawfully slowed down their ability to get parts on a timely basis and increased their costs.[48] Second, the ISOs asserted that GE barred them from attending the training classes necessary to service GE's machines.[49] The case went to trial, with the jury finding that GE violated Section 2 and awarding the ISOs damages of $43.8 million (before trebling).[50] After the court directed a new trial limited to damages, the parties settled.[51]

V. REPAIR MONOPOLY IMPLICATIONS: HEALTH AND SAFETY CONCERNS

By restricting product servicing, repair monopolies restrain competition in the "aftermarket," thereby increasing product customer costs and encouraging wasteful product replacement instead of repair. Equally important, however, as the COVID-19 pandemic has demonstrated, repair monopolies can have potentially life-threatening implications. As summarized earlier, repair monopoly restrictions have hindered the ability of hospitals to repair their own broken ventilators — devices crucial to keeping infected patients in critical condition alive. Ventilator manufacturers have (1) refused to release design schematics and manuals[52]; (2) limited and controlled the distribution of repair parts[53]; and (3) required technicians to attend hard-to-get-into certification programs.[54] Lacking enough working ventilators, doctors confront the gut-wrenching choice of which patients must go without.[55] While some manufacturers loosened their rules, these measures have been described as temporary. That exigencies of the worst healthcare crisis in 100 years produced temporarily relaxed restrictions does not detract from the anticompetitive effects of the restraints.

Cases such as *Kodak* and *Red Lion* offer an antitrust blueprint for challenging ventilator manufacturers' repair restraints. These restrictions are comparable to those successfully attacked in *Kodak* and *Red Lion* as monopolization violations. Since replacement parts and technician training are likely brand-specific, single brand repair and maintenance services are a plausible product market. A technician certified on a GE ventilator model cannot service a Dräger model without a Dräger certification.

And, for certain, ventilators are not unique among the healthcare products subject to repair monopolies; nor are they the only devices where inability to service can cause foreseeable harm to others. Repair monopolies injure not only competing service providers, but also hospitals and other healthcare providers and, indeed, patients who suffered worse outcomes — including death — because operable device supply

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43 *Id.* at 480.

44 *Id.* at 484.

45 *Image Tech. Serv., Inc. v. Eastman Kodak Co.*, No. C 87-1686 AWT, 1996 WL 101173, at *1 (N.D. Cal. Feb. 28, 1996), *aff'd in part, vac'd in part*, 125 F.3d 1195, 1228 (9th Cir. 1997).

46 Complaint, *Red Lion Med. Safety, Inc. v. Gen. Elec. Co.*, No. 2:15-CV-308 (E.D. Tex. Mar. 3, 2015), ECF 1.

47 Memorandum and Opinion, *Red Lion Med. Safety, Inc. v. Gen. Elec. Co.*, No. 2:15-CV-308 (E.D. Tex. Mar. 30, 2018), ECF 247 at 3.

48 *Id.* at 20.

49 *Id.* at 23.

50 *Id.* at 3.

51 *Id.* ECF 347.

52 Jason Koebler, "Hospitals Need to Repair Ventilators. Manufacturers Are Making That Impossible," VICE (Mar. 18, 2020), https://www.vice.com/en_us/article/wxekgx/hospitals-need-to-repair-ventilators-manufacturers-are-making-that-impossible.

53 *Id.*

54 Scher, *supra* note 6.

55 See Kadia Goba, "'I've Never Seen Anything Like This': Doctors Without Enough Ventilators Are Being Told Whom To Save During The Coronavirus Pandemic," Buzzfeed (April 4, 2020), https://www.buzzfeednews.com/article/kadiagoba/ventilator-shortage-new-york-hospitals-coronavirus.

was unlawfully reduced.[56] Injured hospitals that purchase directly from a manufacturer whose restraints create a repair monopoly clearly have an antitrust claim.[57] Insofar as *Illinois Brick's* "direct purchaser" rule makes federal antitrust litigation more problematic for indirect purchaser hospitals and patients, state laws in "repealer" states can fill the vacuum.[58]

Moreover, manufacturer arguments based on insufficiently close causation, albeit predictable, are hardly slam dunks when a repair restraint has forced a hospital to turn patients away or denied a critically-ill patient access to indicated medical treatment. "Congress designed the Sherman Act," the Supreme Court has reminded, "as a consumer welfare prescription."[59]

Equally important, ventilators and other healthcare devices are simply the currently visible tip of the product iceberg. Consider the role "tethering" can play on everyday consumer devices. Tethering is a "strategy of maintaining an ongoing connection between a consumer good and its seller that often renders that good in some way dependent on the seller for its ordinary operation."[60] For example, Apple has used tethering to shut down or "brick" iPhones that were repaired by independent repair shops.[61] Code in the phone's software detects the presence of an unauthorized replacement connector in the device and, once detected, stops the phone from working. While losing access to an iPhone can be a mere "inconvenience," if the phone's owner suddenly cannot make a call in an emergency situation, inoperability can be life-threatening.

Likewise, a driver can be left stranded after the engine in her tethered car shuts off because it was serviced by an "unauthorized" repairperson or because the owner otherwise flouted the terms of service for the software embedded in the car.[62] Just changing a tire on a Tesla is fraught with risk: "If you jack that car in the wrong place, you're damaging the battery, 100 percent."[63] Local repair shops are disadvantaged "[b]ecause the car company makes the information hard to find."[64] And as the "internet of things" develops, the potentially mischievous effects of tethering expand exponentially. A tethered refrigerator could lock the owner out — perhaps, again, only an "inconvenience" where food is sought, but potentially life-threatening if refrigerated medication is needed.

Indeed, even the U.S. armed forces cannot escape these repair monopolies. One Marine Corps captain described an experience in South Korea where a maintenance Marine said he "couldn't fix a broken generator . . . . 'Because of the warranty, ma'am'."[65] She recounted another experience in Japan, "watching as engines were packed up and shipped back to contractors in the United States for repairs because 'that's what the contract says.' The process took months."[66]

Right to repair opponents are inclined to argue that removing or loosening repair restrictions encumbering products would do more harm to the public than good. Thus, in a letter concerning proposed right to repair legislation, AdvMed, a medical device manufacturer trade group representing more than 400 companies, argued that all medical devices should be excluded from such legislation.[67] AdvMed's stated primary concern was that right to repair legislation could result in "maintenance and repairs of medical devices being performed by untrained personnel

56 After the *Red Lion* verdict, healthcare providers brought a class action against GE to challenge GE's gas anesthesia machine service monopoly. *RGOI ASC, LTD. v. Gen. Elec. Co.*, No. CV 18-12624-RGS, 2019 WL 1992436 (D. Mass. May 6, 2019). The court ordered mediation, which eventually resulted in a confidential agreement and voluntary dismissal. *Id.*, ECF 62.

57 See, e.g. *Apple Corp. v. Pepper*, 587 U.S. __, 139 S.Ct. 1514 (2019). *Cf.* IIA Phillip E. Areeda & Herbert Hovenkamp, *et al.*, Antitrust Law: An Analysis of Antitrust Principles and Their Application, ¶345, at 179 (4th ed. 2014) ("standing to recover for an overcharge paid directly to an illegal cartel or monopoly is seldom doubted.").

58 *Illinois v. Illinois Brick Co.*, 431 U.S. 720 (1977). See generally Am. Bar. Ass'n, Indirect Purchaser Litigation Handbook (2d ed. 2016).

59 *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (internal quotation marks omitted). *Cf.* Rebecca Crootof, *The Internet of Torts: Expanding Civil Liability Standards to Address Corporate Remote Interference*, 69 Duke L.J. 583, 588-92 (2019) (in response to physical harm caused by manufacturer-imposed restraints on product operability, expanded civil liability should recognize "broader relational duties," such as "a new implied warranty, a new products liability claim, or a new informal fiduciary duty; and extending proximate cause standards.").

60 Chris Jay Hoofnagle *et. al.*, *The Tethered Economy*, 87 Geo. Wash. L. Rev. 783, 785 (2019).

61 *Id.* at 819.

62 *Id.* at 821.

63 Neil Gladstone, "We need right-to-repair laws now more than ever," Digital Trends (July 18, 2020), https://www.digitaltrends.com/features/right-to-repair-legislation-now-more-than-ever/ (quoting Rich Benoit, host of the "Rich Rebuilds" YouTube channel).

64 *Id.*

65 Elle Ekman, "Here's One Reason the U.S. Military Can't Fix Its Own Equipment," New York Times (Nov. 20, 2019), https://www.nytimes.com/2019/11/20/opinion/military-right-to-repair.html.

66 *Id.*

67 Copy of letter available in Koebler, *supra* note 52.

and that inappropriate replacement parts may be used."[68] Moreover, it claimed that it is "difficult to quantify the potential impact to patient safety from maintenance or repairs being done by improperly trained personnel or from the use of unapproved parts" because "it may not be obvious how the unauthorized repair contributed to the event."[69] However, these protestations are unpersuasive.

In May 2018, the FDA published a report that found "currently available objective evidence is not sufficient to conclude whether or not there is a widespread public health concern related to servicing, including by third party servicers, of medical devices."[70] Instead, "the objective evidence indicates that many OEMs and third party entities provide high quality, safe, and effective servicing of medical devices."[71] This conclusion make sense. Technicians have hands-on training and generally have at least an associate's degree. As a spokesperson for iFixit put it, "[a] biomedical technician is not just somebody walking in off the street."[72] The military, in particular, are well-versed in maintenance and repair: "Marines have the ability to manufacture parts using water-jets, lathes and milling machines (as well as newer 3-D printers), but . . . these tools often sit idle in maintenance bays alongside broken-down military equipment."[73]

Opponents have also put forward hypotheticals (essentially the inverse of the tethering hypos above). At a 2019 hearing concerning a New Hampshire right to repair bill, Sarah Pierce, director of Government Relations at the Association of Home Appliance Manufacturers, warned that owners or independent repair technicians might disable software safety features: washing machines, for instance, use software to disable the spin cycle when a safety latch on the washer lid is opened.[74] Pierce also warned of flaming coffee pots and spoiled food that the right to repair bill could produce.

These excuses should be seen for what they are: a "land grab" by product manufacturers seeking to plant their stake in the service market. Repair monopolies exclude service market rivals and injure downstream users. Thus, they fly in the face of this nation's commitment to robust competition. In 1978, the Supreme Court invalidated a prohibition of bidding for professional engineering services, writing in language equally applicable to opponents of the right to repair:

Exceptions to the Sherman Act for potentially dangerous goods and services would be tantamount to a repeal of the statute. In our complex economy the number of items that may cause serious harm is almost endless — automobiles, drugs, foods, aircraft components, heavy equipment, and countless others, cause serious harm to individuals or to the public at large if defectively made. The judiciary cannot indirectly protect the public against this harm by conferring monopoly privileges on the manufacturers.[75]

So far as we know, buildings and bridges have not since fallen down more frequently than before the Court's ruling.

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68 *Id*. at 1.

69 *Id*. at 2-3.

70 FDA Report on the Quality, Safety, and Effectiveness of Servicing Medical Devices 23 (May 2018), https://www.fda.gov/media/113431/download.

71 *Id*.

72 Scher, *supra* note 6.

73 Ekman, *supra* note 63.

74 Paul Roberts, "In Granite State: Industry Groups Paint Dark Picture of Right to Repair," The Security Ledger (Feb. 11, 2019), https://securityledger.com/2019/02/in-granite-state-industry-groups-paint-dark-picture-of-right-to-repair/.

75 *National Soc. of Professional Engineers v. United States*, 435 U.S. 679, 695-96 (1978).

VI. REPAIR MONOPOLIES: SAND IN THE SADDLE-BAGS OF INNOVATION

Besides excluding rivals, increasing user costs, and producing environmental waste, repair monopolies also inhibit innovation by blocking, throttling, or channeling device improvements. Professor Pamela Samuelson argues that "preserving a substantial zone of liberty within which users are free to tinker with existing artifacts is essential to innovation and the health of the creative ecosystem."[76] Individuals should be free to improve the things they own without asking permission from the product's manufacturer. As the breathing machine valve episode illustrates, the greater the protection given to repair monopolies, the greater the hit to innovation and the social benefit it brings.

In his landmark *Alcoa* opinion, Judge Learned Hand wrote:

> Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.[77]

These observations apply just as much to repair monopolies as they do to product monopolies.

The competition at stake is not just about preventing secondary (aftermarket) repair or preserving a used product market to constrain new product prices and reduce needless replacement of items long before their life cycle ends — features of static competition. It is also about competition in innovation itself — the source of dynamic competition. It is the difference between incremental change–doing essentially the same thing with greater efficiency — and discovering the game-changer — the new approach that does something so differently as to leapfrog the status quo with far-reaching consequences.[78]

VII. CONCLUSION

In recent years, manufacturers have spent a great deal of time and money to establish and entrench repair monopolies. At the same time, purchasers have paid more than they should have for repair or replacement of items purchased. Meanwhile, remedial bills languish in state houses as manufacturers resist proposed legislation. Accordingly, victims should challenge repair monopolies under the antitrust laws. The threat of civil liability, including antitrust treble damages, should help persuade manufacturers to change course.

In the midst of the COVID-19 pandemic, repair monopolies are having a particularly pernicious effect. They are not only injuring healthcare providers economically, but also endangering patients and public safety generally. Eventually, the pandemic will pass. But unless we recall the lessons of competition, the repair monopolies that remain will continue to exact an economic and environmental toll — until the next health crisis reminds us that competition is not just about protecting the value of the customer's dollar or preserving the environment from manufacturer-induced obsolescence, but also about protecting our very physical well-being.

76 Pamela Samuelson, Freedom to Tinker, 17 Theoretical Inquiries L. 563, 565 (2016).

77 *United States v. Aluminum Co. of America*, 148 F. 2d 416, 427 (1945).

78 See generally Michal S. Gal, "3D Challenges: Ensuring Competition and Innovation in 3D Printing," 22 Vand. J. Ent. & Tech. L. 1, 19 (2019) (noting that 3D printing, as an example, could "completely upend[] cost and quality of life considerations in remote areas . . . [and] might affect population distributions, settlement patterns, housing costs, business models, and even equality of opportunity").

REQUESTS FOR INFORMATION IN MERGER CASES: REGULATORY OVERREACH?

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I. INTRODUCTION

The EU Merger Regulation ("EUMR") prescribes the mandatory notification of concentrations with an EU dimension. Notifications must be made using the "Form CO," the completion of which requires very detailed information on, e.g. all potentially affected markets, market share estimates, sales data and the parties' customers and competitors. The Form CO also requires the submission of internal documents, such as board presentations, surveys, analyses, reports and studies discussing the proposed concentration, the economic rationale and the competitive significance or the market context in which it takes place.

In addition to an extensive Form CO, the European Commission ("Commission") collects further information and data via requests for information ("RFIs"). In complex cases, the Commission case team may issue several RFIs per week, most of the time without any advance warning and with very short deadlines. One of the most burdensome RFIs the case team may issue is the request for internal company documents (in addition to the documents requested in the Form CO). Indeed, over time, the Commission has relied increasingly on internal documents obtained through its often overly extensive internal document RFI.

The Commission has broad discretion regarding information requests in view of the "need for speed" in merger investigations. Merging parties who wish to proceed swiftly have no real possibility to moderate or challenge the necessity, scope or response deadline of these RFIs. The Commission's practice surrounding information requests in merger cases raises the question whether or not the Commission overextends its powers and whether the parties' rights of defense are guaranteed.

II. LEGAL POWERS OF THE COMMISSION

A. Sweeping Fact-Finding Powers

The EUMR confers broad investigative powers on the Commission to examine notified concentrations.[2] These powers closely resemble those available under Reg. 1/2003 in antitrust proceedings. RFIs are the main investigative tool used by the Commission to obtain evidence in merger cases, the others being inspections and interviews. The Commission can (and does) issue RFIs at any stage of the investigation and it may collect information from the parties, their customers, competitors and other market participants. The Commission can issue a simple information request (Article 11(2) EUMR), but it can also issue one that is attached to a formal Commission decision obliging the addressee to provide the information requested (Article 11(3) EUMR).

In theory, the Commission's use of information requests is not without limits. Indeed, article 11 EUMR is subject to the principle of proportionality. Caselaw has confirmed that, technically and theoretically, the RFI cannot exceed the limits of what is appropriate and necessary.[3] Moreover, the Commission can only use its fact-finding powers under Article 11 EUMR to the extent it believes that it does not already have the information necessary to conduct an effective review of the compatibility of the concentration with the common market.[4] In addition, an RFI should not constitute a burden for an undertaking that is disproportionate to the requirements of the inquiry.[5]

However, the Commission enjoys a wide discretion regarding the appropriateness, necessity and scope of information requests. The EU Courts have confirmed on many occasions both the Commission's wide discretion and their limited judicial control over that discretion. For example, the General Court has recognized that the subsequent use by the Commission of the information requested may indicate that the information was indeed "necessary," but the fact that the Commission did not use the information is not evidence of lack of necessity.[6]

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2 Articles 11 and 13 EUMR.

3 See, e.g. judgment of July 4, 2006, *easyJet v. Commission*, T-177/04, EU:T:2006:187; Judgment of March 14, 2014, *Schwenk Zement KG v. Commission*, T-306/11, EU:T:2014:123.

4 See, e.g. judgment of November 27, 1997, *Kaysersberg v. Commission*, T-290/94, EU:T:1997:186.

5 See, e.g. judgment of December 12, 1991, *SEP v. Commission*, T-39/90, EU:T:1991:71.

6 Judgment of February 4, 2009, *Omya v. Commission*, T-145/06, EU:T:2009:27.

Similarly, the Commission also seems to enjoy free rein in setting the deadline by which the parties need to provide the requested information. The EU Courts have generally endorsed the Commission's broad discretion to set response deadlines, in view of the "need for speed" which characterizes the general scheme of the EUMR. For example, in *Schneider*, the General Court found that the Commission had acted reasonably, when it had set a deadline of 11 days for one of the merging parties to respond to a 322-question RFI that involved gathering more than 300,000 pieces of information.[7]

The only meaningful limitation to the Commission's powers seems to be that it cannot issue information requests that are excessively succinct, vague, generic or ambiguous. Indeed, in the context of an information request issued during an antitrust investigation, the Court of Justice annulled a Commission decision requesting information because it did not contain an adequate statement of reasons.[8]

B. The Big Sticks in Reserve

Not only does the Commission have broad investigative powers, it also has an array of weapons at hand in case the merging parties do not comply with the information request or provide incorrect or misleading information.

Where the merging parties fail to provide the information requested, provide only a partial response or do not meet the deadline, the Commission can take the decision to suspend the time periods prescribed in the EUMR ("stop the clock").[9] The EUMR dictates that time periods shall only be suspended in "exceptional" circumstances. The Commission also states that suspending the merger review timetable remains exceptional and says it uses suspensions in only "*a handful of very complex in-depth investigations*."[10]

In addition, the Commission can impose fines where companies provide incorrect or misleading information or miss a response deadline set in an RFI by decision.[11,12]

III. RIGHTS OF DEFENSE?

Responding to information requests is a huge burden for the merging parties and can cause serious and appreciable disruption to their day-to-day activities. It requires a lot of effort, sacrifice and indeed many overtime hours. At least one and often several company employees are pulled away from their day jobs and are in effect required to work on RFI responses almost full time.

In complex cases, receiving several information requests per week is not exceptional. This of course must be seen in the broader context of the case team being under significant pressure to conduct its investigation with relative rapidity. However, those circumstances should not be an excuse or a justification for the case team to be unreasonable with deadlines and/or the timing of its RFIs. By way of illustration, in one case of which we are aware, the case team imposed a deadline of 1 hour and 4 minutes to respond to two detailed questions on a proposed divestment package. In another case, the case team issued a heavy information request three days after it had adopted its statement of objections ("SO"), with a deadline to respond that fell before the deadline for the SO response.

Case teams also have no reservations whatsoever about sending information requests on a Friday evening with a deadline to respond on a Monday morning or about requesting detailed information over holiday periods, even when some of the information could clearly have been requested with far more notice.

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7 Judgment of October 22, 2002, *Schneider v. Commission*, T-310/01, EU:T:2002:254.

8 Judgment of March 10, 2016, *Heidelberg Cement v. Commission*, C-247/14, EU:C:2016:149.

9 Article 11(3) EUMR. The same applies when the information the Commission has requested from a third party has not been provided or has not been provided in full within the limit fixed by the Commission, owing to circumstances for which one of the merging parties is responsible.

10 OECD Paper 24 November 2018 – Investigative Powers in Practice – Breakout Session 2. Requests for Information: Limits and Effectiveness – Contribution from the European Commission.

11 Not where a company misses a deadline set in a simple RFI.

12 Article 14 and 15 EUMR. The Commission can impose a fine of up to 1% of total group turnover where companies provide incorrect or misleading information, whether that is in response to a simple RFI or an RFI by decision. The Commission can also impose periodic penalty payments of up to 5% of the average daily turnover for each working day of delay, to compel the undertaking in question to provide complete and correct information which it has requested in an RFI by decision (not in a simple RFI).

As might be expected, the Commission's practice surrounding its requests for information in merger cases raises procedural questions and indeed questions on due process and rights of defense. Indeed, unreasonably short deadlines especially raise eyebrows. Pinning down the right businesspeople for input on an RFI response over the weekend or with a one-hour notice is extremely challenging, at the very least. Couple that with the fact the Commission can fine the merging parties if they provide incorrect or misleading information, or that the Commission can stop the clock if its considers the RFI response to be incomplete, and eyebrows raise even more. One may wonder how far the Commission can stretch the notion of "need for speed" to justify its methods. Too often there would have been no need for haste if the issues had been discussed and the questions agreed earlier.

Given the Commission's wide discretion, it is not surprising that challenging the RFI itself is onerous and that succeeding in such a challenge is virtually impossible.

First, there is no formal process to challenge, e.g. the scope, necessity or time limit of a simple Article 11(2) RFI. The parties are, of course, free to discuss and negotiate with the case team and, for example, ask for an extension of the deadline to respond. However, the case team is usually reluctant to do so and generally only grants short extensions. In addition, while requesting more time may be the knee-jerk reaction, it is possibly not the best strategy as the case team will then (not unreasonably) expect a more comprehensive response and will likely read the response with increased scrutiny.

Second, merging parties that have serious doubts about the proportionality of the case team's information request and do not respond, do not respond in time or only respond in part, will in all likelihood face a formal decision requiring them to provide the missing information. Not only may this lead to bad blood with the case team, it will also suspend the merger review timetable. Needless to say, most merging parties (and their advisors) will not let it come to an RFI by decision and will do everything possible to comply with the Commission's information request, even if they have genuine and well-founded concerns about due process and their rights of defense.

This limited ability for the merging parties to exercise their rights of defense in merger proceedings seems to find some support in Luxembourg. Advocate General Kokott in *UPS* opined that "*the constraints to which the* [Commission] *is subject in relation to merger control (not least considerable time pressure, but also limited resources) must have consequences with regard to the manner in which the undertakings concerned make use of their rights of defence.*"[13]

In addition, the role of the Hearing Officer in merger proceedings is more limited than in antitrust proceedings. For example, if the Commission adopts an RFI by decision, it again chooses the time limit at its discretion. Remarkably, unlike in antitrust proceedings, there is no possibility for the addressees of such decision to request from the Hearing Officer an extension of the time limit for replying.[14]

The merging parties do have the theoretical possibility to challenge the RFI by decision (and the time limit in it) before the EU Courts. The question is whether any such action is truly useful or indeed tactical, as it will definitely trigger hostility with the case team (the people who eventually recommend a final decision on the transaction). In any event, bringing such an action does also not allow for timely redress against a stop the clock decision.

All things considered, the merging parties are largely in the hands of the case team and there is little that is both practical *and* tactical that they can do to moderate the case team's information requests.

13 AG Kokott in Case C-265/17 P United Parcel Service, para. 54. The AG also noted that " […] *despite the unquestionable constraints of merger control proceedings, the undertakings concerned must always be allowed sufficient room for the purposes of their defence and the substance of their rights of defence must not be affected.*"

14 This is usually explained by pointing to two differences between antitrust proceedings and merger proceedings: (i) antitrust proceedings are of a criminal nature and merger control is not; (ii) the conduct of proceedings in merger cases must be adapted to the "need for speed" which characterizes the general scheme of the EUMR. See W. Wils, "The Role of the Hearing Officer in Competition Proceedings Before the European Commission," *World Competition: Law and Economics Review*, Vol. 35, No. 3, September 2012, pp 431-456.

IV. INVESTIGATION OR FISHING EXPEDITION?

Over time, the Commission's approach to evidence in merger cases has definitely shifted towards internal documents. The Commission seems to devote a large part of its limited resources to the review of internal company documents and relies heavily on these documents in its decisions.

Unfortunately, there is no guidance in the EUMR or in any Commission document on, e.g. (i) what internal documents the case team can request; (ii) how it can request these documents; or (iii) how it has to process these documents. In January 2018, the Commission announced its intention to publish "*in the coming months*" a set of Best Practices on requests for internal documents under the EUMR "*to make the process more efficient*," but it has not published any such Best Practices at the time of writing.[15] This long-promised guidance should really be a priority for the Commission.

In practice, the case team simply addresses what can be a draconian request for internal company documents to the merging parties by simple RFI. It can do so in either phase of the investigation, but it will almost always issue an internal document RFI at the start of Phase II. This means that the RFI comes in at the worst possible time for the parties. Indeed, the case team will in most cases issue the internal document RFI at the same time as the parties are scrambling to prepare their response to the Commission's decision to open Phase II,[16] outlining the Commission's serious doubts and concerns, i.e. at a crucial moment in the parties' defense of their case.

The case team's request will require the parties to produce all electronically stored internal documents (including emails, Word and PDF documents, spreadsheets, presentations, etc.) from a number of company custodians within a specified timeframe. The case team will often target people with managerial positions within the company's commercial, business development and R&D departments, but it will usually also ask for the documents and emails of the company's CEO and CFO or, in some instances, even the Chairman of the board of directors of the company.[17]

The case team typically includes a list of broad search terms or keywords (again at its discretion), which are not necessarily confined to the product markets under investigation. Indeed, the keywords often include generic terms such as "invest" or "acquire."

The manner in which the case team frames its internal document request usually leads to hundreds of thousands of responsive documents. Each party needs to extract all these documents from its company servers and from the custodians' laptops, upload them onto a review platform to allow for legal privilege review, and produce them according to the Commission's technical instructions. Each party must also submit a production log, detailing how it extracted, processed and produced the documents, and a privilege log, listing the documents withheld because of legal privilege reasons, including a short summary of each withheld document.

The case team's extremely burdensome and often over-extensive document request raises many issues, key among them those discussed hereafter.

A. No Real Possibility to Moderate or Challenge the Request

As outlined above, there is no formal process to challenge a simple RFI. Usually, however, the case team does send the internal document RFI to the parties in draft before it adopts the official RFI to give the parties the opportunity to provide comments. However, in practice, there is no *real* possibility to discuss the scope of the request as the case team often dismisses any attempt the parties undertake to moderate the request substantially and generally only accepts some minor tweaks on the fringes.

We would suggest that, to mitigate the burdens, the time periods in the internal document RFI should be narrower and more targeted and the custodians from which the case team requests documents should be chosen more carefully and in discussion with the parties. Moreover, the search terms list should not go on for pages and pages, but should instead be carefully designed and transaction-specific.

It should not surprise the case team that each party individually produces hundreds of thousands of documents in response to its overly extensive internal document RFI. Contrary to what the Commission seems to believe, it is rarely a deliberate strategy or gameplay by merging

15 Speech by Commissioner Vestager, "Fairness and competition," January 25, 2018.

16 Article 6(1)(c) EUMR.

17 Some of these documents will, in fact, already be submitted as part of the Form CO.

businesses to "*dump endless documents*" on the case team in the hope that it will miss the needle in the haystack and approve the deal.[18] There is typically no intention to snow the case team with documents; the merging companies are merely complying with the case team's RFI and are producing what the case team has asked them to produce. The fact that the parties often produce more than a million documents combined may just be, in and of itself, evidence that the case team's request is excessive, not at all targeted and, in fact, disproportionate.

B. Inadequate Protection of LPP

Another shortcoming of the internal document RFI is the limited interpretation of legal professional privilege ("LPP"). Based on caselaw in the context of antitrust proceedings, the Commission accepts only three categories of LPP documents in merger cases.[19] The question is whether the copy paste exercise from cartel cases is appropriate.

Indeed, the Commission and the Courts take into account "need for speed" as a specific characteristic of merger investigations to distinguish them from antitrust investigations and explain the more limited options of redress for merging businesses. However, it is a well-kept secret why they do not also take into account other specific characteristics of merger investigations to distinguish LPP in merger cases from LPP in cartel cases.

First, economists often play a vital role in supporting the parties with economic advice, especially in complex cases. The case team's RFIs regularly include questions where the input of economists is essential and economists often advise on, e.g. relevant market definition and theories of harm, as well as potential efficiency arguments the parties could bring forward. To that end, economists are in daily contact with the parties, and provide substantial input, advice and guidance in the context of the Commission's review. However, because of the Commission's narrow interpretation of LPP, advice of economists is often not treated as privileged.

Additionally, many non-EU qualified lawyers may be involved in a large transaction (e.g. U.S. counsel). Technically, their advice is not privileged, and the parties cannot exclude the possibility that the case team would seek disclosure of their communications with such lawyers. Even advice from EU-qualified lawyers can fall outside the scope of LPP in merger cases. That is the case if their advice does not relate to the exercise of the client's rights of defense in competition proceedings, but to, e.g. corporate matters or tax issues. One may wonder why the Commission should see this type of advice and how it fits with the principle of proportionality and the fact that the Commission may only request information that is "necessary" for its investigation.

C. Stop the Clock Threats

As touched upon above, the EUMR prescribes that the Commission should exercise its stop the clock powers only in "*exceptional*" circumstances. Indeed, in theory, it should suspend the review timetable in only "*a handful of cases*." However, stopping the clock seems to have become a relatively common practice in Phase II investigations. Indeed, since 2015, the Commission has stopped the clock at least once in nearly half of the cases that went to Phase II,[20] which demonstrates that it routinely (rather than rarely) uses stop the clock powers to extend its timeframes. Moreover, the Commission is not shy to suspend the timetable by several weeks, or indeed to suspend it multiple times, thereby causing significant delay to the overall deal timeline.

The Commission often links its decision to suspend the timetable to the internal document RFI. For example, in *Dow/DuPont*, the Commission suspended its Phase II investigation twice for a total of 34 working days, mainly to give the parties time to gather internal documents. This is not surprising – as already noted, internal document requests are extremely burdensome and the deadlines are very short. Within the time available, the merging parties often cannot conduct a proper, full-fledged LPP assessment, let alone substantively review the documents they are obliged to produce.

18 Statements by Cecilio Madero Villarejo during the ICN Merger Workshop 2020, Melbourne, Australia, February 2020.

19 The first category consists of written communications with an independent, EU-qualified, lawyer made for the purposes and in the interests of the exercise of the client's rights of defense in competition proceedings (Case 155/79 *AM&S*). The second category consists of internal notes circulated within an undertaking which are confined to reporting the text or the content of communications with an independent, EU-qualified, lawyer containing legal advice provided for the purposes and in the interests of the exercise of the client's rights of defense in competition proceedings (Order in Case T-30/89 *Hilti*). The final category comprises working documents and summaries prepared by the client, if they were drawn up exclusively for the purpose of seeking legal advice from an independent, EU-qualified, lawyer in exercise of the rights of defense in competition proceedings (Case T-125/03 *Akzo*).

20 Since 2015, the Commission has taken 48 Phase II decisions. It has stopped the clock at least once in 22 of them.

As a result, the case team and the merging parties often quarrel about whether the response to the document RFI is complete. The case team will closely scrutinize the privilege log, in particular. It will not hesitate to demand that the parties release more emails or documents if, often judging only by the subject line of the email or the title of the document, the case team suspects that the email or document may not be privileged or is only partially privileged (in which case the parties will need to apply partial redactions). Taking into account the substantial volume of documents, this back and forth leads of course to significant additional work. It is difficult to shake off the impression that the case team is mainly looking to pick holes in the privilege log and uses it as an excuse to stop the clock. Moreover, enormous time pressure and stop the clock threats create circumstances that can make companies waive privilege over whole categories of documents (some of which may be at least partially privileged).

An additional complication is that there is no clawback procedure for inadvertently disclosed privileged documents. In addition, the Hearing Officer cannot intervene in a situation where the merging parties have not initially withheld the document from the Commission, but later claim that, because of legal professional privilege, the document should be removed from the Commission's file.[21] The merging parties are thus in the hands of the case team and have to try to negotiate any restitution with the case team.

D. Overreliance on a Narrow Set of Internal Documents

Another major issue with the document RFI is that the case team seems to consider the hastily collected and reviewed internal documents as a primary source of evidence to substantiate its findings on, e.g. market definition, closeness of competition and the impact of the transaction.

While internal documents are indeed one of the relevant inputs to take into consideration in the assessment of a merger, it is by no means the only input. The case team should weigh the evidence in the internal documents fairly against the input of the parties during the proceedings (e.g. the Form CO, White Papers, RFI responses, and presentations at State of Play meetings), input from economists and feedback from the market (also if it is positive).

Moreover, some internal documents are simply not suited to be used as reliable sources for the case team's analysis, and definitely not when taken out of context. Some documents are mere drafts or do not necessarily paint a full picture of, e.g. the competitive landscape (e.g. vendor due diligence reports). The case team should seek the parties' views on the provenance and reliability of a document before attaching importance to it.

Additionally, it seems the case team can sometimes be rather one-sided in its use of the internal documents. For example, in *Ineos/Solvay/JV*, the merging parties argued that the case team had overemphasized a small number of inculpatory statements and ignored many exculpatory documents. The Commission responded by stating that, *inter alia*, it is under "*no obligation to provide a detailed assessment of all the documents in its file*" because "*that would be incompatible with the need for speed and the short timescales which the Commission is bound to observe* […]" (emphasis added).[22]

However, it is vitally important that the case team does not search the internal documents primarily for evidence underpinning or supporting the theory of harm it has decided to pursue. The case team must refrain from cherry picking internal documents, and must undertake a fair assessment of the evidence on file, i.e. regard the totality of the evidence (*à charge* and *à décharge*).

E. No Obligation to Assist with the Document Review

Another issue with the Commission's increased appetite for internal documents is the question whether the parties should assist with the review of those documents. If the Commission in subsequent RFIs probes the parties on the internal documents produced in response to the document RFI, the parties should of course cooperate and respond. The parties themselves may also choose to review the documents they have produced (which, because of the short deadline, they can actually only do *after* production) to point the Commission to evidence that supports their case.

However, in some misleading information cases we are aware of, the Commission seems to take the position that the parties should also point the case team to internal documents that do not help their case, even if the case team had not explicitly asked for those documents or posed any questions relating to them. The Commission seems to be trying to establish a principle that the duty of the parties is to "please answer any of the questions that we should have asked or that we would have asked if they had occurred to us."

21 See W. Wils, "The Role of the Hearing Officer in Competition Proceedings Before the European Commission," *World Competition: Law and Economics Review*, Vol. 35, No. 3, September 2012, pp 431-456.

22 Case M.6905 – *Ineos/Solvay/JV*, para. 55 and fn. 22.

This approach brings to mind the privilege against self-incrimination. It is difficult to conceive of a legal basis under EU law for an obligation on the merging parties to help the Commission find documents that may harm their case. The parties cannot be obliged to respond to questions the case team should have asked, but did not.

V. CONCLUSION

Law and procedure have evolved over time, but now need clarity. If the Commission chooses to rely heavily on internal documents, it must ensure that a streamlined and predictable process and sufficient internal checks and balances are in place to ensure a fair and balanced approach to evidence collected from the parties' internal documents, and to safeguard the parties' rights. The Commission needs to produce the long-promised guidance, which needs to be pragmatic, recognize the heavy burden on the parties and must ensure a less confrontational procedure.

In light of the frequent disagreements between the parties and the case team, e.g. relating to legal privilege, the role and mandate of the Hearing Officer needs to be expanded to ensure speedy resolution of conflicts. To that end, it may be wise to have some Hearing Officers with experience in private practice.

CHINA: NON-COMPETE CLAUSES IN THE TRANSACTIONAL CONTEXT

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1 Adrian Emch is partner at Hogan Lovells in Beijing. The views expressed in this paper are personal, and do not reflect those of Hogan Lovells or its clients. The author thanks Prof. Liyang Hou, Qing Lyu and Hazel Yin for their comments on earlier drafts. Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007.

I. INTRODUCTION

Non-compete clauses in agreements between competitors can be problematic under antitrust rules. China is no exception. A large part of the enforcement cases brought by Chinese antitrust regulators since the Anti-Monopoly Law ("AML")[2] came into effect close to 12 years ago concerned agreements where competitors decided not to compete on certain parameters of competition (such as price), or not to compete at all. Before Chinese courts too, a good number of cases concerned cartel agreements,[3] even though there are the odd cases where judges greenlighted seemingly hardcore cartel conduct.[4]

A sub-set of non-compete arrangements between competitors – those entered into within the context of a structural transaction (using the AML's terminology, a "concentration between business operators") – has received very little attention by legislators and regulators in China. There is a lack of explicit rules as to whether and how non-compete obligations can be justified in the transaction context.

In contrast, foreign antitrust laws provide some guidance. In the European Union, for example, the European Commission issued the Notice on restrictions directly related and necessary to concentrations ("Ancillary Restraints Notice").[5] As its title indicates, the notice states that those restrictions that are directly related – i.e. economically related to a "concentration" and intended to allow a smooth transition to the changed company structure post-concentration – and necessary – in the sense that the concentration could not be implemented, or only with considerably higher uncertainty, cost or difficulty – are automatically covered by the European Commission's decision on the concentration.[6] These directly related and necessary restrictions – dubbed "ancillary restraints" – are among others meant to protect the value transferred or to enable the start-up of a new entity.[7] Non-compete clauses are explicitly mentioned as ancillary restraints, both for acquisitions and joint ventures. The general rule is that non-compete obligations on the seller (in an acquisition) and on the joint venture and its controlling parent companies (for a joint venture) are ancillary, if their scope does not exceed what is required in terms of duration, geography and products.[8] The duration is three years for acquisitions and the lifetime of the joint venture.[9] The European Commission decision in *Siemens/Areva* follows the same approach for non-compete obligations imposed on a controlling parent company exiting the joint venture.[10]

In China, as noted, there are no explicit rules on ancillary restraints on the books. Against this background, in the following section, I will attempt to analyze ancillary restraints under the existing *general* antitrust framework.

2 Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007.

3 Around one third of allegations concerned horizontal agreements, although some of them were clearly without proper reasoning or factual basis.

4 *Hui'erxun Co., Ltd. v. Shenzhen City Pest Control Association*, Guangdong High People's Court, [2012] Yue Gao Fa Min San Zhong Zi No. 155, December 2012; *Niannian Red Brick Factory v. Zhang Daoxian*, Hubei High People's Court, [2017] Yue Min Zhong No. 402, Jun. 22, 2017.

5 European Commission Notice on restrictions directly related and necessary to concentrations, [2005] OJ C 56/24.

6 *Id.* paras. 10-13.

7 *Id.* para. 13.

8 *Id.* paras. 20 and 36.

9 *Id.* paras. 10-13. If the acquisition only involves goodwill but no knowhow, then only two years' non-compete arrangements are covered by the Ancillary Restraints Notice.

10 *Siemens/Areva*, Case COMP/39736, June 18, 2012.

II. ANALYSIS WITHIN EXISTING LEGAL FRAMEWORK

Below, I will attempt to assess ancillary restraints first under the existing merger control rules and then under the monopoly agreement rules.[11]

A. Merger Control Rules

The AML's merger control rules do not address the situation of ancillary restraints head-on. However, one could argue that the antitrust authority – the State Administration for Market Regulation ("SAMR") – in *practice* includes ancillary restraints in its clearance decisions.

The reasoning goes as follows: if a non-compete obligation is directly related and necessary for the merger under review, it would typically be included in the transaction agreement (e.g. Sale and Purchase Agreement or Joint Venture Agreement). Since the merging parties are required to submit the transaction agreement as part of their notification to SAMR, SAMR should consider the agreement as part of its review of the transaction.

In addition, a SAMR implementing rule requires the merging parties to lay out the horizontal or vertical cooperation agreements in the relevant market, such as those relating to R&D, patent licensing, joint production or distribution, and long-term information exchanges.[12] That rule does not appear to be limited to agreements between the merging parties only. However, to the extent that the merging parties do list agreements of the types mentioned in the provision, they would appear to be (at least potentially) ancillary to the concentration. In short, this provision seems to provide a venue for merging parties to list ancillary restraints.

The substantive benchmark for SAMR's merger review is to assess whether the "concentration between business operators has or is likely to have the effect of eliminating or restricting competition."[13] Given that SAMR's mandate is to consider the concentration as a whole, it is arguable that its clearance decision includes all parts of the concentration which are directly related and necessary for its conclusion and implementation. In that regard, Article 28 of the AML stipulates that SAMR can clear a concentration "if the business operators can prove that the positive impact of such concentration clearly outweighs the negative impact." Even though in all likelihood this wording is meant as a possibility for the merging parties to argue efficiencies and the burden of proof lies with the parties, the wording appears to acknowledge that SAMR clearance can be granted even when certain aspects of a concentration restrict competition, as could arguably be the case for non-compete clauses.

As a final point, in practice, SAMR's unconditional clearance decisions do not explicitly state that the concentration does not restrict competition. They merely say, in one way or another, that SAMR does not object to the concentration being implemented. However, the decisions also state that "matters relating to the concentration between business operators other than the anti-monopoly review should be conducted in accordance with the relevant laws." A reading *a sensu contrario* would suggest that all matters relating to the anti-monopoly (i.e. merger) review are covered by the SAMR decisions – which would suggest a broad scope of coverage.

Since the merger of the previous three antitrust authorities in 2018, a single authority (SAMR) is now in charge of enforcing the merger control and monopoly agreements rules. In practice, this should mean that it is (much) less likely that SAMR would seek to apply the monopoly agreements rules to a concentration it previously approved under merger control rules.

B. Monopoly Agreements Rules

The above analysis under merger control rules can only apply to concentrations which are notified to SAMR. If a concentration is not reviewed by SAMR, then there is no clearance decision which could give coverage to ancillary restraints.

Against this background, it is necessary to examine ancillary restraints under the general monopoly agreements rules in the AML. The relevant provisions are the prohibition of anti-competitive horizontal agreements (Article 13) and the exemption mechanism (Article 15).

As a first step, it seems clear that a non-compete clause between competitors may breach one or more of the provisions in Article 13(1), in particular the market-partitioning prohibition. The second step of the analysis is more interesting – whether the transaction context can provide a legitimate justification for applying the exemption mechanism.

11 The term used in the AML to describe anti-competitive agreements is "monopoly agreement" or "monopolistic agreement."

12 Guiding Opinion on the Documents and Materials for the Notification of Concentrations between Business Operators, AMR Anti-Monopoly Bureau publication, September 29, 2018, http://gkml.samr.gov.cn/nsjg/fldj/201907/t20190726_305196.html, art. 7.

13 AML, arts. 3(3) and 28.

Article 15 lists a number of circumstances which can justify the disapplication of the prohibition at Article 13, including improving technology or R&D, improving product quality, reducing costs, efficiencies in standardization or specialization processes, etc. Unfortunately, there are no detailed rules on how to implement Article 15.[14] The question then becomes whether the pro-competitive nature of the main transaction – the concentration – can be sufficient ground for a finding of efficiency or other pro-competitive effects.

An additional requirement by Article 15 is that the agreement (here, the non-compete clause) does not significantly restrict competition in the relevant market and allows consumers a share of the resulting benefit.[15]

In short, at least for those concentrations which do not need to file with SAMR under the merger control rules, the AML's monopoly agreements framework does not provide clear guidance on non-compete clauses in the transactional context. There is still considerable uncertainty for these concentrations. In the next section, I will show that this concern is not merely hypothetical.

III. RECENT COURT CASES

During the course of 2019 and 2020, there were some cases before Chinese courts which show how they struggle with (the absence of guidance on) non-compete clauses in the transaction context. This section will describe four relevant court cases.

A. Xin Jilong v. Hefei Xuegong

On March 23, 2019, the Shenyang Intermediate People's Court rendered its judgment in *Xin Jilong v. Hefei Xuegong*.[16] That case concerned the establishment of a green-field joint venture between an individual (Xin Jilong) and a company (Hefei Xuegong).

The joint venture was set up to manufacture and sell starch adhesives in certain designated regions in Northern China. The joint venture was green-field, with Hefei Xuegong providing the technology and Mr. Xin injecting cash. The exact shareholdings and the "controlling rights" in the joint venture do not become apparent from the judgment. Although Mr. Xin was allegedly the main shareholder and actual controller of the joint venture, the judgment does not give clear indications whether the joint venture was joint controlled in a merger control sense.

The joint venture agreement included a non-compete obligation on the joint venture and Mr. Xin (as its alleged actual controller): they committed not to sell, or partner with third parties regarding, starch adhesives outside the joint venture's geographic scope. The goal was of this non-compete obligation was to protect Heifei Xuegong, seemingly active mainly in Southern China, which had shared its technology with the joint venture.

However, from 2015 to 2016, the joint venture *did* sell into territories outside the designated scope. As a result, Heifei Xuegong brought a lawsuit for breach of the joint venture agreement and sought compensation for damages from Mr. Xin.

At first instance, the Dadong District People's Court ruled for the plaintiff.[17] In his defense, Mr. Xin counter-argued that the non-compete obligation (i.e. not to sell outside the designated territory) was akin to a market-partitioning cartel, as Hefei Xuegong and the joint venture were competitors. However, the first-instance court held the non-compete obligation on Mr. Xin to be valid on the grounds that the defendant was Mr. Xin — not the joint venture — and that Mr. Xin and Hefei Xuegong were both shareholders of the joint venture, not competitors.

As a result, the Dadong District People's Court ruled that Mr. Xin had breached his non-compete obligation by allowing the joint venture to sell outside the designated geographic scope. At second instance, the Shenyang Intermediate People's Court simply upheld that ruling without further analysis.

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14 One of SAMR's predecessor authorities – the antitrust unit within the National Development and Reform Commission – had published a draft guideline on the Article 15 exemption. *See* State Council Anti-Monopoly Commission Guideline on the General Conditions and Procedure for the Monopoly Agreement Exemption (Draft for Comments), May 12, 2016. However, that guideline only focused on procedural aspects, and gave no guidance on the substantive criteria in Article 15.

15 In *Yutai*, the Supreme People's Court distinguished two types of agreements with a different burden of proof for SAMR in enforcement cases: those "per se" illegal and those which are not (the latter essentially requiring a "rule of reason" type of analysis). See *Hainan Yutai Technological Fish Feed Company v. Hainan Price Bureau*, Supreme People's Court, [2018] Zui Gao Fa Xing Shen No. 4675, Dec. 18, 2018. The court allocated market-partitioning agreements between competitors to the "per se" box, without detailed discussion. However, as noted, while a non-compete clause in a concentration may look like a market-partitioning agreement on its surface, there is a specific background: the concentration. It is not clear how this specific fact pattern would fare under the *Yutai* criteria.

16 *Xin Jilong v. Huefei Xuegong Adhesives Technology Group Co., Ltd.*, Shenyang Intermediate People's Court, [2019] Liao 01 Min Zhong No. 3318, Mar. 23, 2019.

17 *Huefei Xuegong Adhesives Technology Group Co., Ltd. v. Xin Jilong*, Dadong District People's Court, [2017] Liao 0104 Min Chu No. 11405, Mar. 23, 2019.

If we were to examine this case by reference to the EU's Ancillary Restraints Notice, we would first need to examine whether Hefei Xuegong had joint control over the joint venture company, given that the notice's coverage only applies to obligations imposed on controlling parents. If so, then it would seem lawful to impose a non-compete obligation on the joint venture and the other joint controller (Mr. Xin) not to compete in Hefei Xuegong's reserved territory. The key idea behind is that Hefei Xuegong might not have shared its technology with the joint venture, absent protection of its existing business, which in turn suggests the non-compete obligation was instrumental for Hefei Xuegong to agree to set up the joint venture in the first place.

B. Li Sheng v. Shi Hailiang

On June 18, 2019, the Gongzhuling District People's Court in Jilin Province issued its judgment in *Li Sheng v. Shi Hailiang*.[18] That case involved the acquisition by one individual (Shi Hailiang) of a truck and a dish washing business from another individual (Li Sheng). In the transfer agreement, Mr. Li as the seller committed not to operating any dish washing business in the same town in the future.

However, not before long, Mr. Li sued Mr. Shi before court. He claimed that Mr. Shi had not made full payment for the acquired business. In return, Mr. Shi alleged that Mr. Li continued to offer dish washing services and thereby breached his non-compete obligation.

In its judgment, the Gongzhuling District People's Court ruled that Mr. Shi's acquisition led to Mr. Li's exit from the dish washing market and Mr. Shi's market entry. Without any in-depth analysis, the court held the arrangement to amount to market-partitioning in breach of the AML and held the entire transfer agreement to be invalid.

Using the EU's Ancillary Restraints Notice as benchmark again, a non-compete obligation on the seller in an acquisition would not be unlawful if limited to a period of three years (or two years if there is no knowhow involved). In this case, however, it seems there was no time-limit on the non-compete obligation, which seems to go beyond what is necessary to protect the value of the assets to be transferred to the buyer.

C. Li Yangzhong v. Yang Daba

On November 4, 2019, the Yuanjiang Autonomous County People's Court decided the *Li Yangzhong et. ali v. Yang Daba* case.[19] This case involved a partnership to operate a dish washing business in Yuanjiang, a county in Yunnan Province.

The partnership included eight individuals (the seven plaintiffs and the defendant, Yang Dada). The partnership agreement prohibited a partner from operating a dish washing business in Yuanjiang after leaving the partnership. However, after his exit from the partnership, Mr. Yang poached four employees from, and started competing with, the partnership by offering dish washing services in the same county.

As a result, the other seven partners sued Mr. Yang before court requesting compensation for damages. They alleged that Mr. Yang's breach of the non-compete obligation caused significant damage to the partnership: prior to Mr. Yang's partnership exit, the partnership was the only dish washing operator in town, and subsequently Mr. Yang managed to poach 20 percent of its customers. In defense, Mr. Yang argued that the non-compete obligation was unlawful under the AML.

In its judgment, the Yuanjiang Autonomous County People's Court ruled that the non-compete clause was designed to protect fair and reasonable competition and to prevent unfair competition. The court reasoned that as a partner in the partnership's business, Mr. Yang was familiar with the partnership's work streams, business models, and customer data. He was also found to have a fiduciary duty which is reflected in the non-compete clause. The court held that the non-compete cause was compliant with all laws and regulations.

On the facts, the court found that Mr. Yang started competing with the partnership within five months after his departure, and thereby caused damages to the partnership. As a result, the court found a breach of contract, and ordered Mr. Yang to pay RMB 300,000 compensation to the plaintiffs.

Under the EU's Ancillary Restraints Notice, this case would be assessed as a joint venture scenario. Non-compete obligations would be lawful during the lifetime of the joint venture under that notice, and for a period of up to three years after exit from the joint venture under *Siemens/Areva*. As noted, the coverage by the Ancillary Restraints Notice only extends to controlling parent entities of a joint venture. In this case, it

18 *Li Sheng v. Shi Hailiang*, Jilin Gongzhuling District People's Court, [2019] Ji 0381 Min Chu No. 1634, Jun. 18, 2019.

19 *Li Yanzhong et al. v. Yang Daba*, Yuanjiang Autonomous Country People's Court of the Hani, Yi and Dai Nationalities, [2019] Yun 0428 Min Chu No. 965, Nov. 4, 2019.

is not clear whether Mr. Yang had a controlling stake. Since the joint venture in this case was a partnership and generally partners are meant to put most or all of their efforts into the partnership, it is likely that Mr. Yang's role was, in practice, that of a controlling parent.

Assuming that Mr. Yang had joint control, according to the *Siemens/Areva* decision, a non-compete obligation can be accepted as reasonable for departing joint venture parents, if limited to three years.[20] In this case, there was no time-limit for the obligation even after Mr. Yang's departure. At the same time, however, Mr. Yang started competing with the partnership already within five months of his departure – which is still within the three years' period outlined in *Siemens/Areva*.

D. Lei Qiang v. Shi Qinghua

On May 20, 2020, the Dazhou Intermediate People's Court ruled in the ***Lei Qiang v. Shi Qinghua et. ali*** case.[21] This case pitched an individual (Lei Qiang) against the other shareholders of a joint venture whole-selling pre-packed flour in Dazhou, a city in Sichuan Province.

In February 2018, Mr. Lei decided to merge his flour business into the joint venture. As part of this deal, Mr. Lei acquired a 5 percent shareholding in the joint venture in exchange for a payment of RMB 1 million and two non-compete commitments: (1) not to operate a competing flour business in Dazhou (which I will call "narrow non-compete clause") and (2) to "restrict" Liu Deping's flour business ("broad non-compete clause"). Liu Deping was Mr. Lei's former business partner. Their previous joint venture was terminated in 2018, when Mr. Lei joined the defendants' joint venture. According to the agreement Mr. Lei signed with the new joint venture, a breach of the commitments could be sanctioned.

Mr. Lei duly paid the capital for his shareholding in the joint venture, but in August 2018 the board of the company found him to be in breach of his non-compete commitments. In particular, the board found that Liu Deping (Mr. Lei's prior business partner) continued to operate a flour business under a different name after Mr. Lei had become a shareholder of the joint venture. As a result, the board decided to impose a penalty of RMB 400,000 on Mr. Lei and reduced his shareholding to 3 percent. Mr. Lei sued the other shareholders before the Tongshun District People's Court in Dazhou, alleging that the broad non-compete clause (not the narrow non-compete clause) inter alia breached the AML's abuse of dominance rules.

At first instance, the Tongshun District People's Court dismissed the AML claim, finding that the joint venture was not dominant.[22] The court went further and held that the arrangement between Mr. Lei and the other shareholders did not amount to a monopoly agreement either. The court's key argument was the broad non-compete clause was a unilateral expression by Mr. Lei, not an agreement between shareholders to restrict the conduct of a third party, Liu Deping. In the court's view, Liu Deping's conduct was not impacted and there was no exclusion of competition from third parties.

On appeal, the Dazhou Intermediate People's Court upheld the first-instance decision. The court focused on Mr. Lei's specific claim (i.e. abuse of dominance) and held that he did not provide evidence on the joint venture's market share, market conditions, pricing power etc. to prove it is dominant.

In short, in *Lei Qiang v. Shi Qinghua et. ali*, the plaintiff only challenged the broad non-compete clause under the AML's abuse of dominance and the courts (at least the second-instance court) only responded to this specific plea. The case is somewhat of a missed opportunity, as the narrow non-compete clause would have raised interesting questions under the monopoly agreements rules.

If we were to apply the logic of the EU's Ancillary Restraints Notice, as noted, non-compete obligations can only be imposed on controlling shareholders of a joint venture. From the judgment it does not become clear, but it is unlikely that Mr. Lei obtained joint control in the sense of Chinese merger control rules (with a shareholding of only 5 percent). From that angle, leaving aside the question of ex officio application of rules (without allegations by the parties), the narrow non-compete clause would appear questionable.

In short, I hope my description of the four judgments in 2019 and 2020 – in particular the different outcomes against similar factual backgrounds – shows that Chinese courts are struggling in this area. My conclusion is therefore that, beyond concentrations that are filed with SAMR under merger control rules, the existing AML framework does not provide sufficient guidance for non-compete clauses in the transactional context.

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20 If Article 15 of the AML were invoked, the exemption would only be available if the agreement does not significantly restrict competition. In this case, the plaintiffs themselves stated in their filings that they were the only marketplayer in town, so the non-compete clause arguably eliminated all competition.

21 *Lei Qiang v. Shi Qinghua et ali*, Dazhou Intermediate People's Court, [2020] Chuan 17 Min zhong No. 111, May 20, 2020.

22 *Lei Qiang v. Shi Qinghua et ali*, Tongshun District People's Court, [2019] Chuan 1702 Min Chu No. 1060, Aug. 8, 2019.

IV. CONCLUSION

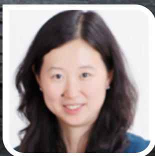
The AML and its implementing rules do not contain explicit guidance on how to deal with non-compete clauses and other ancillary restrains in the transaction context. Nonetheless, the four judgments from 2019 and 2020 described in this paper show that the lack of guidance leads to uncertainty for market players.

The existing legal framework provides for some comfort if the concentration is notified to, the non-compete clause is reviewed by, and the concentration receives clearance from, SAMR. Where this not the case, the AML's monopoly agreements rules do not provide sufficient guidance.

Against this background, it would be advisable for the legislator to provide guidance in the ongoing AML revision or – perhaps more feasible in practice – for SAMR to issue AML implementing rules on this point. An alternative would be for SAMR to establish a visible case practice, for example on how to interpret and apply Article 15 of the AML. After all, non-compete clauses and other ancillary restraints are a business reality in and outside China. As the country is in the process of recovering from the COVID-19 crisis and M&A activity is expected to rebound, Chinese regulators should provide a clearer legal framework on non-compete clauses in the transactional context.

NEW WINE INTO NEW WINESKINS: ANALYZING HUB-AND-SPOKE ANTITRUST CASES IN CHINA

BY JOHN JIONG GONG, VANESSA YANHUA ZHANG & RITA XIAOPING LI[1]



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I. INTRODUCTION

The antitrust legal and economic communities have traditionally treated anticompetitive behaviors as dichotomized along horizontal and vertical dimensions. Horizontally, such behaviors are called "collusion" or "conspiracy" among industry competitors, whereas otherwise they are called vertical restraints between an upstream firm and a downstream firm. In China, the Anti-Monopoly Law ("AML") has Article 13 and Article 14 to deal with horizontal and vertical antitrust offenses respectively. But in the real world, a firm's potential alleged anticompetitive behavior sometimes encompasses both dimensions. For example, a manufacturer may implement policies to coordinate among its distributors that may be subject to scrutiny of Article 13.[2] Such coordination may involve the distributors appearing to collude on price or quantity. A powerful distributor in a particular region may also coordinate activities of several manufacturers it represents to achieve a certain collusive goal. These types of activities involving both horizontal and vertical angles represent the focus of some recent developments in antitrust law enforcement in China. This article attempts to provide a brief introduction to the hub-and-spoke theory, highlight some relevant cases in China, and provide economic analysis to compare the Chinese courts' and competition authorities' approaches to such behaviors.

The reason why the kind of behavior at issue in this paper is called "hub-and-spoke" is because there is usually a key player, using the analogy of a wheel, acting as the "hub," and vertical agreements with other associated players in a different layer of distribution acting as the "spokes" of a wheel. The basic thrust of the theory about such conspiracy is that fundamentally vertical agreements could have horizontal anti-competitive implications, and thus need to be brought into the realm of antitrust law enforcement.

However, how that vertical-horizontal link works is not entirely obvious, nor is it obvious that the actors involved would have clear motivations and incentives to be engaged in anticompetitive behaviors, and that said behaviors would always result in actual harm to competition. In the AML context, there are quite a lot of debates on how hub-and-spoke cases should be approached and if they would cause competition harm. In the proposed amendment of the AML, hub-and-spoke conspiracy was raised as an important issue and a new Article 17 was intended to be introduced to prevent undertakings from organizing and facilitating other undertakings to engage in monopoly agreements.[3] We start our analysis by first classifying hub-and-spoke conspiracies into three categories.

The first category includes conspiracies that would enhance market power or reduce competition at the level where the hub operates. For example, Toys "R" Us once had vertical agreements with its upstream manufacturers that limit their supplies to warehouse club stores competing with Toys "R" Us.[4] In this case, Toys "R" Us was also found to have coordinated horizontal agreements among its manufacturer suppliers. This kind of arrangement clearly is meant to strengthen Toys "R" Us' market dominance.

The second category covers conspiracies that would enhance market power or reduce competition at the level where the spokes operate. This would be common in scenarios where a manufacturer coordinates among its distributors via vertical agreements with its distributors. In this case if the manufacturer holds a small market share, it is not entirely clear how limited competition within a brand would fester into limiting competition across the entire relevant market.

The last category, as expected, refers to conspiracies that would increase market power or reduce competition at both levels. For example, a distributor sitting in the hub coordinates collusion among its upstream manufacturer suppliers, who in turn agree to take some actions that help the hub distributor reduce competition with rival distributors. The anticompetitive nature of this type of hub-and-spoke conspiracy and the resulting harms to competition are less controversial, since the incentives of the participants and the grounds for their liability tend to be fairly obvious.

In short, not all hub-and-spoke cases are created equal, and thus they, according to the usual analytical framework under China's AML, naturally call for a certain degree of economic analysis to discern their participants' incentives and resulting extent of competition harms before their illegality can be established. Below we review two representative cases in China to understand the courts' and the competition authority's approaches to such matters, followed by some caveats to conducting relevant antitrust economic analysis.

2 See more detailed discussion on horizontal monopoly agreements in Vanessa Yanhua Zhang and Xinzhu Zhang, "New Wine into Old Wineskins: Recent Developments of China's Competition Policy against Monopolistic/Collusive Agreements," Review of Industrial Organization, Vol. 41, Issue. 1 (2012), pp. 53-75.

3 SAMR Draft Amendments to the Anti-Monopoly Law (Open for Public Comments), January 2, 2020, available at http://www.samr.gov.cn/hd/zjdc/202001/t20200102_310120.html; the consultation draft (in Chinese) can be accessed at http://www.samr.gov.cn/hd/zjdc/202001/P020200102375329388627.docx.

4 *Toys "R" Us, Inc v. FTC*, 221 F. 3d 928 (7th Cir. 2000).

II. HUB-AND-SPOKE CASES IN CHINA

In China, hub-and-spoke cases have been treated as vertical restrictions on price which is articulated in Article 14 and horizontal monopolistic agreement which is prohibited by Article 13. Although the AML does not elaborate the situation, the main principles which were laid out in both Articles 13 and 14 provide the legal foundation for the competition agencies and the court to treat it differently.

Competition agencies have adopted the per se illegal doctrine when dealing with hub-and-spoke cases. The representative administration investigation case was held by Hubei Price Bureau. The provincial agency discovered that the Audi sales division of FAE-Volkswagen had coordinated its ten Audi dealers in Hubei province to implement monopoly agreements since 2012.[5] This conduct involved both horizontal agreements and vertical restriction on automobile and maintenance services prices. These ten dealers were Hubei Ding Jie, Hua Xing Han Di, Hubei Zhong Ji, Hubei Ao Ze, Wuhan Ao Long, Wuhan Ao Jia, Xiangyang Dong Fu, Yichang Ao Long, Huangshi Ao Long and Shiyan Ao Long. Those ten Hubei dealers had signed the Audi Restricted Price Program of Wuhan District, Guarantee to the Price Program of Central China under the coordination of the Audi Sales Division. Meanwhile, the Audi Sales Division had released the Notice on Strictly Implementing the Audi Standard Price System in Hubei province and Hubei Service Marketing Management Rules and further set up the supervision groups to monitor the implementation of the internal rules.

The provincial antitrust agency also discovered that several Hubei dealers mentioned above had set up the monopoly agreement regarding automobile sales, which left the evidence in the meeting memorandums of Unified Price Program for Dealers of Wuhan. Deemed per se illegal by the provincial agency, Volkswagen was found manipulating the resale prices of automobiles and prices of maintenance services between Audi dealers and third parties. The agency found that Volkswagen had eliminated and restricted the competition in the automobile and auto parts markets by fixing and restricting the minimum resale prices and coordinating on the monopoly agreements. For those ten Hubei dealers, they were deemed violating Article 13 by price conspiracy while playing secondary role in execution of the monopoly agreement. Therefore, in September 2014, Volkswagen was fined 248.58 million RMB by the Hubei Price Bureau under the direction of the National Development and Reform Commission ("NDRC") and Hubei Dingjie, Hubei Zhongji as well as other 6 dealers received 29.96 million RMB fine which was comparably much lower than Volkswagen's.

The court system, however, takes a completely different approach from that of the competition agencies. The court normally adopts the rule of reason doctrine when dealing with the hub-and spoke-cases. The Rijin v Panasonic case ruled by the Shanghai No. 1 Intermediate People's Court is a representative one to illustrate the difference.[6] Panasonic Electronics, manufacturer of a set of factory automation control equipment including mostly programmable logic controllers, low voltage electric transformers and generic sensors, has a contractual relationship with its distributors. The document called "Panasonic Eastern China End Customer Management Charter," in fact establishes a client protection system, through which valuable and important clients are protected from being approached by other distributors who previously do not have an existing business relationship with these clients. Before approaching a prospective client, a distributor needs to refer to the client database to ensure that this prospective client has not worked with another distributor. This client protection mechanism takes the form of Resale Price Maintenance ("RPM") where other distributors' price quotes to a protected client have to be at least 15 percent higher than the standard distributor-suggested-price by Panasonic. This client protection mechanism ensures that the quoted price of an unrelated distributor is incompetent, therefore, protects the incumbent distributor.

In 2014, Rijin Electric Co., one of Panasonic's regional distributors, brought an antitrust lawsuit against Panasonic along with two other distributors for allegedly forming a monopoly agreement for a market division scheme. Initially the plaintiff did not make it clear what particular type of monopoly agreement it was referring to, and did not specify whether it was a vertical monopoly agreement ruled by Article 14 of the AML or the horizontal monopoly agreement ruled by Article 13 of the AML. Later on, the plaintiff switched to a horizontal agreement allegation during the rest of the trial. The court determined that the case involved a conduct in the realm of vertical monopoly agreement and dismissed all anti-competitive allegations and damage claims brought by the plaintiff.

On June 29, 2016, the court dismissed all the plaintiff's allegations. The judge clearly stayed with the defendants' position that Article 13 of the AML did not apply in this case. By applying the rule of reason doctrine, the judge further stated that even if a horizontal agreement

5 "Hubei Punished FAW-Volkswagen Co., Ltd. and some Audi Dealers for Price Monopoly," Hubei People's Government, September 11, 2014, available at http://www.hubei.gov.cn/xxbs/bmbs/swjj/201409/t20140911_1204351.shtml.

6 *Shanghai Rijin v. Panasonic Electronics*, Civil Judgment of Shanghai No. 1 Intermediate People's Court, (2014) HU YI ZHONG MIN WU (ZHI) CHU ZI No. 120, June 29, 2016, available at http://cclp.sjtu.edu.cn/Show.aspx?info_lb=672&info_id=3943&flag=648. A detailed discussion of the case is included in Gong, John J. and Vanessa Y. Zhang, Vertical Restraints versus Horizontal Agreements in the Manufacture-Distributor Relationship, CPI Antitrust Chronicle, March, Volume 3, Winter 2017, available at https://www.competitionpolicyinternational.com/vertical-restraints-versus-horizontal-agreements-in-the-manufacturer-distributor-relationship/.

among parallel members (meaning distributors) within a vertical relationship possibly precluded and limited intra-brand competition, meaning the competition among distributors of the same producer, such an agreement might not extend to harm inter-brand competition of the entire market. Therefore, such a hub-and-spoke agreement where a horizontal agreement within a vertical relationship may not be such a kind of horizontal monopoly agreement prohibited in Article 13 of the AML. He further stated that only competing parties owning different brands and forming a horizontal agreement could possibly preclude and limit competition, and Article 13 of the AML should only apply to those circumstances.

III. ECONOMIC ANALYSIS FRAMEWORK OF HUB-AND-SPOKE CASES

Above all, the analytic framework we would have in mind with respect to hub-and-spoke cases follows the traditional antitrust economic thinking where incentives, acts and consequences of harm to competition need to be established in the process. This almost invariably calls for a rule of reason approach to such cases. But the issue of rule of reason versus per se illegal is not without controversy, and as we have demonstrated earlier that it is not even consistently applied via administrative versus judicial venues in China.

In the Audi Dealer case, the competition authority took the per se illegal position, whereas the court presiding over the Panasonic case resorted to rule of reason. We take the position that, under the current AML legal environment, most hub-and-spoke cases should be viewed as cases of derivative extensions of vertical monopoly agreements, as they almost always involve some kind of vertical agreements. Consequently, litigations under Article 14 should adopt the rule of reason approach as mandated by court precedents. Economic theories in this regard postulate both harms and benefits associated with vertical restraints and thus analysis is warranted to detect its net effect in real industry settings.

Second, incentives and motivations of participating in a hub-and-spoke conspiracy on the part of all players usually need to be established in a typical rule of reason analysis. But sometimes it is not obvious nor reasonable for spoke players to demonstrate such incentives. In the first type of hub-and-spoke conspiracy, while the anticompetitive incentive of the hub distributor is easily understandable, it is hard to answer the question as to why the spoke manufacturers would be complicit in conduct that only increases the market power of the hub distributor, when doing so could result in the hub distributor exerting buyer power or charging a higher resale markup at the expense of the manufacturers' sales volume. In addition, the exclusive dealing requirement with the hub distributor would further forego sales opportunities to other distributor competitors. In the analysis, how much the hub distributor's market power plays a role in the dealings might be an important factor to consider.

Another important incentive issue in the second category of hub-and-spoke cases is with respect to the motivations behind distribution coordination, which may not be solely driven by price or quantity oriented collusive purposes. A manufacturer may have other pro-competition and legitimate considerations, for example, to serve its industry clients better, in which case it ultimately aims to intensify inter-brand competition, although apparently it may reduce intra-brand competition. For example, in a public or private tender setting, a manufacturer may select its most competitive and representative distributor to participate in terms of its service track record, financial standing, cost efficiency, supply chain capacity, and a slew of other considerations. In this case, sending one most competitive distributor bidder to the tender effectively intensifies inter-brand competition in the market, especially in the relevant market where the manufacture does not hold any dominant position.

Third, analysis of market power associated with participants is important in assessing any anticompetitive harm. In the second category of hub-and-spoke cases, the hub's market power is of particular importance. The anticompetitive theory is basically premised upon a theory of limitation on intra-brand competition can possibly spill over to the entire relevant market to cause any competition harm. But how this actually works appears to be in lack of any theoretical economic foundation and more importantly rigorous empirical evidence. As we have mentioned earlier, distribution coordination could be motivated by pro-competitive and legitimate considerations other than price or quantity driven collusive purposes, in which case it actually intensifies inter-brand competition. In our opinion the hub player is supposed to play a central role in the hub-and-spoke conspiracy theory, and thus how that role translates into harm to competition in the entire relevant market is critical to analyzing such cases.

Last but not least, we propose that the legislation body might consider setting aside a separate clause or a provision under the proposed Article 17 of the draft amendments to the AML to deal with such instances of violation in the next round of legislative revision. Hub-and-spoke cases are indeed quite different from horizontal and vertical violations as regulated under Article 13 and Article 14. It may require a place of its own in the upcoming newly revised statute. And the statutory texts should reflect its unique and complex characteristics and prescribe an enriched set of legal solutions to deal with it.

IV. CONCLUSION

Our paper introduces the concept of hub-and-spoke anticompetitive conspiracy, which is quite problematic in China, and some cases in China that fit this category. We are of the opinion that a rule of reason doctrine needs to be considered when discussing these cases in court. And we propose an economic analysis framework that looks at the incentives, the market power of participants and the resulting harm to competition in analyzing these cases. The AML in China is under a new round of legislative revision. It might be a good opportunity to introduce an independent clause to deal with prospective hub-and-spoke antitrust violations that encompass both horizontal and vertical relations in the marketplace.

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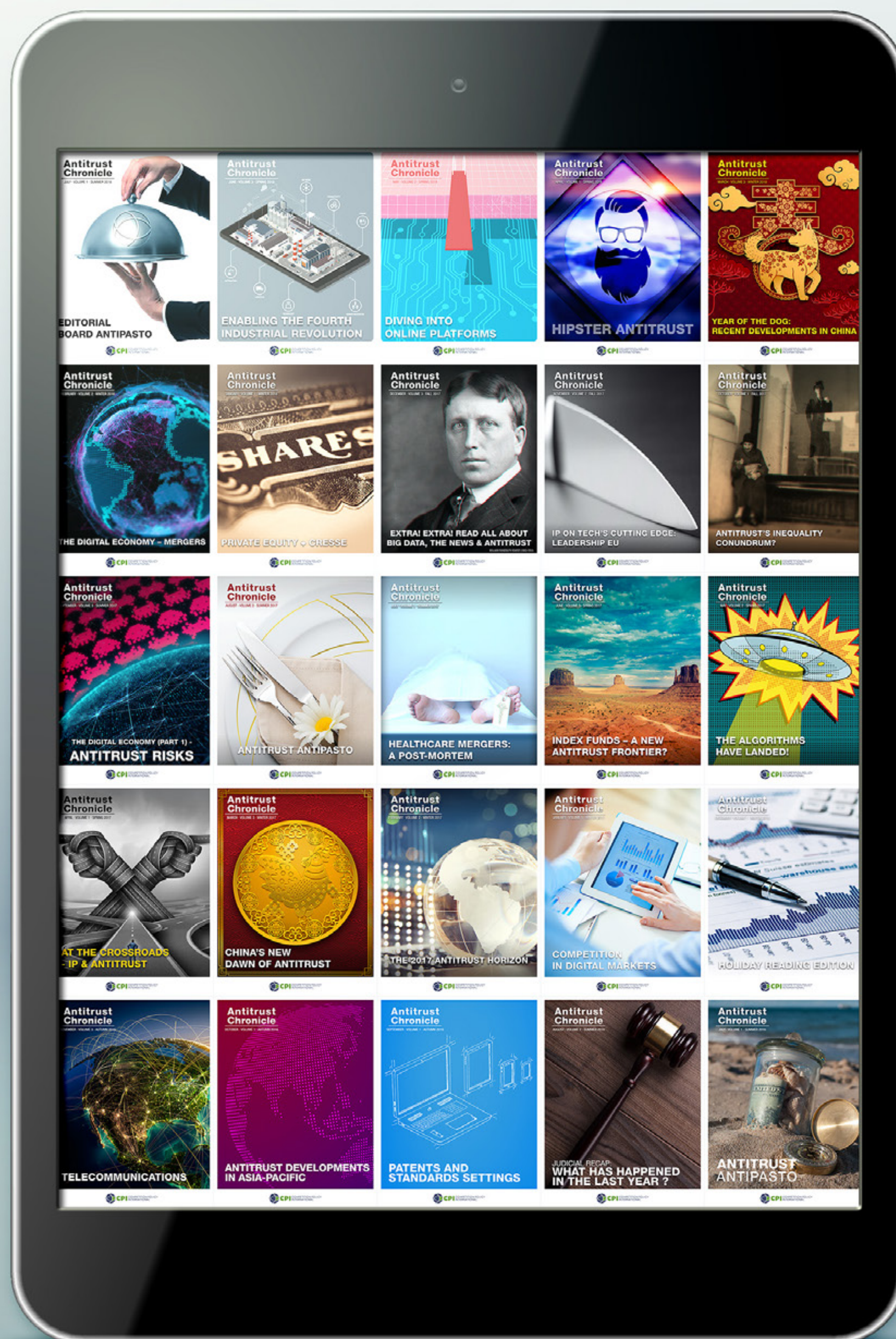

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