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Antitrust Enforcement and Civil Rights: SEPs and FRAND Commitments

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Antitrust Enforcement and Civil Rights: SEPs and FRAND Commitments

Bo Vesterdorf[1]

I. INTRODUCTION

The views expressed in this article are inspired by two recent decisions taken by the European Commission ("Commission") on April 29, 2014, the *Motorola*[2] and the *Samsung*[3] decisions. These decisions are the first Commission decisions concerning competition law enforcement in relation to standard essential patents ("SEPs"). In essence the Commission has found that, in certain circumstances, seeking and enforcing an injunction may constitute an abuse of dominant position. This raises important constitutional issues with regard to civil rights.

For centuries it has been a fundamental element of democratic countries governed by the rule of law, such as the Member States of the European Union, that, if private parties cannot agree on issues of a legal character, they will have access to a court which will decide in a final and binding manner on the dispute between the parties. They would not be turned away by the court unless there was no legal issue to decide upon.

This right of access to a court is a fundamental right enshrined in Article 6(1) of the European Convention of Human Rights and in Article 47 of the Charter of Fundamental Rights of the European Union. Neither of these two articles recognizes any exception to the right of access to court. It is in principle an absolute right and it is only for the national court in question to decide whether the case brought shall be admitted or dismissed; a dismissal may be decided by the national court if, for example, it finds the application vexatious or manifestly unfounded. It follows from this fundamental civil right that a person who has brought a case before a national court should not be prosecuted or punished for doing so, neither by administrative authorities nor in principle by the courts. This is a fundamental principle of law also within the area of EU competition law. The two recent decisions by the Commission do not, however, seem compatible with that principle.

II. THE *MOTOROLA* AND *SAMSUNG* DECISIONS AND QUESTIONS RAISED

The Commission's decision of April 29 this year, in which Motorola was found guilty of abuse of dominance by infringing Article 102 TFEU because it had sought and enforced an injunction against Apple in Germany on the basis of a SEP, which it had committed to license on Fair, Reasonable and Non-Discriminatory terms ("FRAND") seems difficult to reconcile with this fundamental principle. Basically, the Commission found that since Apple had declared itself

[1] Former president of the Court of First Instance of the EU (now the General Court), consultant to the law firms of Herbert Smith Freehills and Plesner. The article is not intended to be an academic article but rather personal reflections some of which were presented at a conference in Brussels on June 23, 2014.

[2] Case AT.*39985 - Motorola - Enforcement of Gprs Standard Essential Patents.*

[3] Case AT.*39939 - Samsung - Enforcement of UMTS Standard Essential Patents.*

willing to take a license on the SEP and to be bound by a determination by a German court of the FRAND royalties for the license, it was an abuse of dominance by Motorola to go to a national court to seek and enforce an injunction against Apple. However, in view of the novelty of the case, the Commission decided not to impose a fine on Motorola.

Second, on the same day, the Commission, instead of perhaps adopting a decision like in the *Motorola* case, adopted a decision under Article 9(1) of Regulation 1/2003 which made commitments, offered by Samsung to meet the Commission's competition concerns, binding on Samsung. These commitments are aimed at putting an end to a long lasting dispute between Samsung and Apple on terms which the Commission found eliminated its concerns.

These two cases concern the same issue, namely whether a SEP holder, who has committed to grant licenses on FRAND terms could be in breach of the prohibition on abuse of dominant position under Article 102 TFEU, by seeking and enforcing an injunction against another party's new or continued use of the SEP. If this is the case, as was found by the Commission, it represents a novel approach which will give rise to considerable concern for those who have invested, often huge sums of money, in new technology for which they have obtained a patent which they, on the one hand, declare to be a SEP and, on the other hand, commit to license on FRAND terms which—as the Commission clearly recognizes—is of great value and importance to society in general.

If such SEP owners, when they believe that the only way to get an implementer (a possible licensee) to accept to take a license is to seek an injunction against the unauthorized and thus illegal use of the SEP, run the risk of being found to abuse a dominant position with the ensuing risk of potentially large fines, it puts them in a position of unwarranted legal uncertainty. This may discourage them from contributing their technology to standards and from accepting to commit to license on FRAND terms, or even discourage them from investing in R & D as much as they would otherwise have done. Such a possible consequence of the Commission's recent decisions would be very unfortunate for society in general and not necessarily bring about any immediate advantages for consumers that might sufficiently counterbalance these long-term risks.

As the Commission itself stated in both decisions, seeking an injunction before the courts is generally a legitimate remedy for patent holders in case of patent infringements. In fact, such injunctions are sought before national courts around the world practically every day and constitute a necessary means of protecting patents against infringements. It is a fact of life that third parties very frequently either deliberately, negligently, or simply by lack of knowledge of an existing patent infringe patents. If and when the patent holder becomes aware of such infringement, the normal and legitimate reaction will be to try to stop the infringement by (i) contacting the infringer and asking him to stop the infringement, (ii) asking him to take a license, or (iii) seeking an injunction before the relevant court.

An ordinary patent holder, under general patent law, is not normally obliged to give a license on the patent, but may indeed prefer to produce the goods himself. If, on the other hand, he agrees to grant a license, it is in principle for the patent holder himself to decide the rate of the royalty, just as a shop owner is normally entitled to decide at what price he wants to sell his goods. However, EU competition law also applies to patent holders, which means that they may

not abuse their dominance (provided dominance effectively exists) for example by demanding excessive royalty, by tying, or by discriminating. For the purpose of this article, I base myself on the situation of a SEP holder who is in a dominant position.[4]

In the two decisions of April 29 this year the Commission found that, under the *special circumstances* of these cases, namely that the SEP holders had committed to license on FRAND terms and where the other party was willing to enter into a license agreement, the seeking and enforcement of an injunction may constitute an abuse of dominance. The competitive harm, which according to the Commission may be caused by such an injunction, would be the risk of excluding products from the market (the so-called patent hold-up issue).[5] The Commission further argued that the threat of seeking an injunction may distort licensing negotiations and lead to anticompetitive licensing terms.[6]

When a patent holder declares his patent to be a SEP, he indicates to the world that—in his view—this patent is indispensable for anyone in order to meet/comply with a certain standard. The declaration of the SEP will normally be made to one of the standard-setting institutes, such as ETSI—the European Telecommunications Standardization Institute. Whether the claimed SEP is actually a standard essential patent is not verified by the standardization institute. In the two cases mentioned, the SEPs concerned the GPRS standard, part of the GSM standard. Under normal practice for ETSI, if a patent holder declares his patent to be a SEP, he must at the same time agree to license the SEP on FRAND terms. This agreement establishes in reality a third-party legal right to obtain a license on such terms; a right which the third party can in principle enforce before national courts vis-à-vis the SEP holder on the condition that the third party is willing to pay the royalty demanded by the SEP holder in so far that the royalty/or other terms claimed are found to be FRAND.[7]

As the Commission itself states in the decisions, it is also a logical consequence of its approach to these problems that, if the potential licensee is not willing to take a license on FRAND terms, the patent holder is clearly entitled to and thus does not abuse his dominance by seeking and enforcing an injunction if the other party either starts to or continues to use the SEP.

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[4] In the two decisions, the Commission based its findings on the existence of dominance by the SEP holders. Even though, of course, a patent grants the owner exclusivity as to the patent, it does not necessarily follow from this that patent holder obtains sufficient market power to become dominant. It is a fact that the SEP holder can only enforce its right through courts (after a court review) when faced with a licensee unwilling to take a license. There is no other way for the SEP holder to force an infringer to stop unauthorized use of the SEP. There may also be other existing technologies, either patented or non-patented, which may compete with the SEP to the extent that such technologies allow to circumvent the technology of the SEP and thus allow the implementer to comply with a certain standard.

[5] It is, in this regard, worth noting that the mere seeking of an injunction does not necessarily lead to immediate exclusion of the product concerned for the simple reason that such cases will very often be pending before the national court concerned for a long time before the court finally decides to grant the injunction. Only when a granted injunction is actually enforced will the product be barred and withdrawn from the market.

[6] It should be noted in that regard that the threat from a potential licensee of complaining to the Commission about alleged abuse may also distort licensing negotiations and thus lead to anticompetitive licensing terms.

[7] In such a case, the burden of proof regarding the question of whether the royalty demanded by the SEP holder is supra-FRAND will rest on the applicant. If, however, the applicant has initially been able to demonstrate sufficiently that the royalty seems likely to be supra-FRAND, the SEP holder will be submitted to rules of disclosure to allow the court to decide the case.

The key questions in this regard are first, whether the SEP holder has complied with his FRAND undertaking, i.e. whether the royalty demanded is FRAND, and, second, whether the potential licensee is willing or unwilling?

A. When Is A Price FRAND?

As to the first question of when a price is FRAND, there is no clear-cut answer to be found either in legislation or in the case law. In deciding on this, consideration should be given to a number of factors potentially relevant in the specific case, such as:

- value of end product and the relative importance of the SEP to the end product,
- importance of the relevant standard,
- how big is the market and what is the potential licensee's market share,
- number of competitors (other SEP holders and manufacturers),
- size of turnover and profits to be made,
- price of comparable licenses granted by the SEP holder, and
- strength of the SEP (or a SEP portfolio).[8]

Given that there is no clear-cut answer to the question of what a FRAND price is, I think it must be generally accepted that no **one** price is the **only right** FRAND price and that one must therefore operate within a range of prices with an upper and a lower limit. To provide a hypothetical example, $1.26 is not necessarily the only right FRAND price, it may be anywhere between $1 and $2. In such a scenario, if the SEP holder demands $3 per unit, his offer cannot be considered to be FRAND[9] just as, if the potential licensee insists on paying only $0.85, he is insisting on a sub-FRAND price and should not be considered to be a willing licensee, i.e. not willing to pay a fair price for the license.[10] If, on the other hand, the potential licensee declares to be willing to pay $1.05, he must in principle be considered a willing licensee. If in that situation the SEP holder still wants $1.95 per unit, he is, however, in our example requesting a FRAND price and there does not seem to be any legal or economic reason to insist that he should accept the lower price offered by the other party or for that matter just a lower price.

As this example demonstrates, if the SEP holder is within the FRAND range, he is offering a license on FRAND[11] terms. He is in principle entitled to say no to the potential licensee and, if that person nevertheless either starts or continues to use the SEP, the legal and logical

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[8] In this article I only discuss the issues seen in relation to a single or a very limited number of SEPs. In cases of licensing of a portfolio of SEPs the question of a FRAND royalty and a willing licensee is in principle the same but is, on the one hand, more complicated because of the number of SEPs and, on the other hand, less complicated because the royalty will not be based on a calculation of the sum of individual royalties for each SEP in the portfolio.

[9] In such a case the court should not grant an injunction.

[10] The fact that a SEP holder has accepted to license on FRAND terms does not only mean FRAND vis-a-vis the licensee but also a fair price for the SEP holder.

[11] It should logically follow that the first step in a case, in which an injunction is applied for, is that the judge should start by examining whether the royalty demanded by the SEP holder /the applicant is FRAND. If it is, there is no legal, economic, or any other reason to examine whether any counter offer by the implementer/potential licensee is also FRAND but lower.

consequence must be that the SEP holder is entitled to seek and enforce an injunction without having to fear that he may be fined by a competition authority for an infringement of competition law.

To take this reasoning a bit further, are there really sufficient legal reasons to find a punishable infringement of competition law if a SEP holder could reasonably believe that a price of $2.50 was within the FRAND range? I do not think so since deciding the FRAND range is in any event a difficult and not at all straightforward exercise. In that respect, it should not be forgotten that the case law under Article 102 TFEU regarding unfair prices as an abuse[12] indicates that for a price to be considered to be unfair it must be found to be excessive. In the words of the Court of Justice in *United Brands,*[13] a price will be excessive if it "has no reasonable relation to the economic value of the product."[14]

In other words, the price must be found to be not only above, but also much above the economic value of the goods in question. Only if it is excessive, may demanding such a price constitute an abuse. I fail to see any legal reason why a SEP holder should be found guilty of abuse and fined in so far as he could reasonably believe that his price was FRAND, i.e. not manifestly above what the FRAND range is later found to be in the specific case. It should also not be forgotten that the court dealing with an application for injunction normally has, or at least should have, discretion to refuse the application if the royalty asked for by the applicant is clearly supra-FRAND.[15]

B. When Is the Potential Licensee/Implementer a Willing Licensee?

As to the second question of when the potential licensee/implementer is a willing licensee, the answer must obviously depend on all the circumstances of the specific case. On the one hand, he is clearly not a willing licensee if he simply refuses to pay any royalty for the use of the SEP. If, on the other hand, the implementer has declared that he is willing to pay for the license and does so in a manner that clearly indicates his commitment to conclude a binding license agreement, the starting point just as obviously is that he is in principle a willing licensee.

It is, however, not enough to just declare oneself to be willing. This must be shown by concrete follow up actions such as signaling a commitment to conclude a binding license agreement and not frustrating negotiations by (i) not answering within a reasonable time, (ii) not insisting on terms clearly outside the bounds of what may reasonably be considered to be FRAND, or (iii) not continuously demanding new and supplementary but clearly unnecessary information to cause further delays. Furthermore, another clear way of demonstrating real willingness to take a license would be to start paying at least what the potential licensee himself

[12] In cases regarding infringement of Article 102 TFEU, the Commission and the courts will normally be looking at the behavior of the dominant undertaking. This should also be the case in the type of scenario dealt with in this article. In other words, it needs first to be examined whether the SEP holder has complied with his obligation, which is to offer licenses at a royalty that is within the FRAND range. If that is the case, he is entitled to that royalty.

[13] *Case 27/76 - United Brands Company and United Brands Continentaal BV v Commission of the European Communities.*

[14] *Id.*, ¶250.

[15] If the court makes it clear to the applicant that it considers dismissing the application for that reason, it would most likely lead the applicant to settle the case with the implementer by lowering the royalty demanded.

may have presented as a counter offer or by paying into an escrow account the amount requested by the SEP holder.

But what if the potential licensee insists on paying what is clearly a sub-FRAND royalty? Is the SEP holder in that situation not entitled to consider him an unwilling licensee? Or what if the potential licensee accepts to pay within the FRAND range but insists on an amount at the bottom or the lower end of the range whereas the patent holder wants a royalty at the top or at the higher end of the range and thus within the FRAND range? As indicated above, I find that the patent holder is legally – as well as from both an economic and moral point of view - entitled to that price and can refuse the licensee without infringing either his FRAND commitment or competition law. In that regard the SEP holder must also pay attention not to discriminate with respect to potential previous licenses granted to other parties at a price decided by him within the FRAND range.

Should competition law be able to force the SEP holder to keep on negotiating with the potential licensee towards a lower price? In this regard, it is worth observing that the role of competition law and competition authorities is not to be price regulators or to decide the prices of specific individual contracts. If the price requested by the patent holder is within the FRAND range and thus FRAND, that must be it, and it is neither for the competition authorities nor the courts to force the patent holder to accept a lower price. Nor can it legally, or from an economic point of view, be the case that the SEP holder should be obliged to continue to negotiate over and over again, month after month, in an attempt to reach an agreement which would inevitably end up being below his own FRAND price. Is there any legal, economic, or moral reason why one should give priority to the interests of the potential licensee over the rights of the one who, as is most often the case, has invested heavily in R & D and thus managed to get a patent of perhaps essential importance to some standard?

What about the argument that, if a SEP holder demanding supra-FRAND royalties can say no and may seek injunctive relief, this may force the potential licensee to accept a higher than FRAND price or otherwise end up in the so-called "patent hold-up" situation? There is some truth in this argument in particular if national courts omit to hear potential claims about non-compliance with FRAND commitments by the SEP holder and thus allow such a behavior. The argument is, however, not very convincing for the simple reason that the Commission also accepts that the SEP holder may seek injunctions if the other party is not a willing licensee.

In other words, the Commission accepts that seeking an injunction may be not only acceptable, but may also be something which may force the other party to the negotiation table, or back to it. As suggested above, an implementer is not just an unwilling licensee if he totally refuses to pay a royalty but also—in my opinion—if he insists on a price that is clearly sub-FRAND and, indeed in reality, also when the potential licensee refuses to pay the FRAND price requested by the patent holder. However, in the *Motorola* decision, the Commission states that, if the potential licensee declares himself to be willing to have the question of the royalty decided by courts or arbitration, the SEP holder must consider him a willing licensee and can therefore not

seek and enforce an injunction without running the risk of being found guilty of abuse.[16] That may be considered to be a safe harbor, I agree, to the extent that the SEP holder—if he accepts such an indication by the potential licensee—does not run the risk of being fined by the Commission. It is, however, not only somewhat surprising but also legally unacceptable if that should be **necessary** in order to avoid fines.

Compare this to the situation where an Aston Martin stops outside a jeweler's shop and the owner of the Aston enters the shop, picks up a Piaget gold watch with a price tag of £25.000, puts £20.000 on the desk, and leaves with the watch saying "I am a willing buyer but your price is too high; this is my price, sue me in court if you want the remaining £5.000 and, if the court says I must pay £23.000 or £25.000, I'll accept that." We would be somewhat surprised if the shop owner were told that he cannot go to the police but must wait for a judge to tell him whether his price was fair or unfair.

It cannot be right, without a specific legal basis to that effect, that if the potential licensee clearly refuses to pay the FRAND royalty demanded**,** the SEP holder must nevertheless allow him to start or continue to use the SEP and wait until a judge or an arbitrator tells him whether his price was fair/FRAND, even if he is aware that the licensee is clearly capable of paying him compensation when—and if—some years later[17] a judge decides that way.

It should not be forgotten that implementers very often either "forget" or use every trick in the book to avoid taking a license or at least try to drag out[18] negotiations for as long as possible; in practice sometimes for months or years, without paying anything in the meantime. The "Orange Book" principle, adopted by some courts in Germany, is not something followed voluntarily by all implementers and is not in all respects an ideal solution since it has in practice meant that a potential licensee has had to give up his right to challenge validity in order to be permitted to raise competition law claims in his defense.

If, however, the SEP holder, when he may reasonably find a potential licensee unwilling in the sense indicated above, decides—as he should be allowed to without fear of being fined—to seek an injunction, the defendant should of course remain free to claim not only non-infringement or invalidity of the patent, but also abuse of dominance. Such questions will be examined and decided by the national court, which is both competent and under a duty to apply article 102 TFEU if the pleas and facts of the case make it relevant. That the SEP holder runs that risk before the national court is a consequence of the rights of defense of the defendant but it is also quite different from running the risk of being prosecuted and punished by a competition authority such as the Commission for going to court in accordance with the fundamental right of access to courts.

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[16] In cases of portfolio licensing, it would create serious problems for the licensor if the fact that a potential licensee agrees to adjudication of the royalty for just one single (out of the number of patents in the portfolio) SEP would necessarily mean that the potential licensee must be considered to be a willing licensee with the effect that this would exclude the possibility of seeking an injunction. Such a state of law might have the negative effect to destroy portfolio licensing and thus a system that appears to have worked fine and to the advantage of all parties involved.

[17] It is well-known that injunction proceedings may take very long time, often up to 2-3 years.

[18] For instance, by insisting on taking licenses on a patent-by-patent basis and then only after having litigated each patent all the way.

Furthermore, under the Commission's approach of finding abuse where a SEP holder who has given a FRAND commitment seeks an injunction in a situation where the two parties cannot agree on the royalty (for example where the potential licensee simply does not accept the FRAND price requested by the patent holder), one risks creating the opposite situation where the SEP holder finds himself forced to accept a lower royalty than the FRAND royalty he demanded, simply to avoid the risk of having the Commission make a finding of abuse, impose a fine and thus punish him.[19]

It is often argued that a SEP holder should in general refrain from seeking injunctions because he may obtain compensation for the use of the SEP, if necessary, by bringing a normal case for damages before the relevant court. This is not a convincing line of argument: first, because it results in compensation for past use and does not concern future use; second, because it would force the patent holder to bring successive court actions if the infringing implementer does not stop the illegal use of the patent; and third, because it simply misses the point that nobody should have to accept that an illegal use of the patent can go on and on. The illegal use is in reality a form of theft and the courts are there to protect owners against such theft.

The Commission, which—with its approach taken in the recent decisions—has created unwarranted one-sided barriers for SEP holders' access to have their cases examined by national courts, should generally leave this type of case to national courts which are used to dealing with patent litigation and which are—as I said—both competent and obliged to apply Article 102 TFEU if the circumstances of the case and the pleas in law lead to it.

III. THE ABUSE OF DOMINANCE QUESTION

Let me then, finally, address the question of whether going to court to seek a solution to litigation between two parties may constitute an abuse of dominance. The Commission has said yes and relies in this regard on former judgments of the EU courts relating to refusal to deal, including cases such as *Magill*,[20] *IMS Health,*[21] and *Microsoft,*[22] in which the courts found that in **exceptional circumstances** an IP right holder may be under an obligation to grant a license. These cases did not, however, regard the question of whether going to court in itself may constitute an abuse. Furthermore, they did not at all concern the type of situation dealt with above concerning SEPs and contractual FRAND commitments where the SEP holder has already promised in a legally binding way to license the technology.

As mentioned above, the questions in SEP- and FRAND-related cases concern, in principle, only two things: Has the SEP holder complied with his FRAND commitment by having offered what is FRAND in the given case? Is the other party in reality a willing licensee? If the price requested by the SEP holder is found to be FRAND, even if at the higher end of the FRAND range, and the potential licensee refuses to pay that price, is it then legally an abuse for the SEP holder to seek or enforce an injunction?

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[19] This might have further consequences with regard to previously granted licenses.

[20] *Joined Cases 76, 77 and 91/89 R - Magill TV Guide/ITP, BBC and RTE*

[21] *Case C-418/01 - IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG*

[22] Case T-201/04 - *Microsoft Corp. v European Commission*

The General Court has dealt with this very question of whether seeking an injunction may constitute an abuse in its judgments in *ITT Promedia*[23] and *Protégé International.*[24] In these cases the General Court found that, in order for this to constitute an abuse, two cumulative conditions must be met. First, it must be the case that the action by the dominant firm cannot reasonably be considered as an attempt to establish its rights and second, that the action was conceived within the framework of a plan whose goal was to eliminate competition.

The Court stressed that as the right to assert one's rights in court and subject them to judicial control is a fundamental right, it can only be in "wholly exceptional circumstances" that the bringing of proceedings before a court may constitute an abuse of dominance, and it stressed that the two criteria must be construed and applied strictly. It is difficult to see how the decisions by the Commission fulfill these two criteria.[25] It is, of course, as already mentioned, the case that neither of these two judgments by the General Court concerned the SEP and FRAND scenario. The decisive element of the two court cases was, however, **that the applicant tried to seek protection for his rights**, just as the SEP holder tries to seek protection for his rights if an unwilling licensee either starts or continues to use a SEP without paying the royalty demanded, provided that the royalty asked for by the SEP holder could reasonably be considered to be FRAND.

IV. CONCLUSION

Instead of having this kind of commercial dispute being handled by the Commission under Article 102 TFEU, I believe that it is best left to national courts. This dispute is, in principle and at the heart of it, nothing more than specific and concrete litigation between two private parties regarding the price for a product. A SEP holder should not be put in a situation where he must seriously consider the risk of fines for abuse of dominance just because he does not accept the lower royalty rate acceptable to the potential licensee who may perhaps be called a willing licensee, but only on his own terms, and where the rate may be either sub-FRAND or at the bottom or lower end of the FRAND range as opposed to the high end FRAND terms requested by the SEP holder.

The national courts dealing with such cases are better placed to decide whether an application for injunctions should, exceptionally and under the specific circumstances of an individual case, be considered abusive or not.

It should furthermore, and finally, be mentioned that the approach adopted by the Commission in these cases must give rise to concerns of a more constitutional nature. It is, in democratic countries based on the rule of law, a basic and fundamental principle, which follows from the generally accepted principle of separation of state powers, that neither parliament nor government may interfere in cases brought before the national courts. It is not for those state organs to prosecute and punish citizens for seeking protection for their rights before the courts. Starting competition law infringement proceedings against an undertaking which has brought a

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[23] *Case T-111/96 - ITT Promedia NV v Commission of the European Communities*

[24] *Case T-119/09 - Protégé International Ltd v European Commission*

[25] The *Samsung* decision is a commitment decision that will probably not be brought before the General Court and, according to the press, the *Motorola* decision will not be appealed.

case before a national judge, simply for doing so, seems hardly compatible with the duty to respect the fundamental principle of right of access to courts and non-interference in that regard by administrative bodies.

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Identifying Benchmarks for Applying Non-Discrimination in FRAND

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Identifying Benchmarks for Applying Non-Discrimination in FRAND

Dennis W. Carlton & Allan L. Shampine [1]

I. INTRODUCTION

Standard setting organizations ("SSOs") have for many years asked members to commit to license patents essential to use of standards on Fair, Reasonable and Non-discriminatory ("FRAND") terms.[2] Because SSOs have not defined explicitly what FRAND means, courts and regulators have been forced to interpret it. We have previously written on how standard setting that incorporates patents can lead to complicated situations in which the patent owner, sometimes in collaboration with rival firms, can exploit the market power that is created by being designated a standard essential patent ("SEP"). We have also shown how the non-discriminatory prong of FRAND can be interpreted so as to mitigate the inefficiencies that can result when patent owners try to exploit their market power conferred by the standard-setting process.[3]

Here, we discuss the availability of appropriate benchmarks for implementing the non-discriminatory provision. While any benchmark provided by a license to a "similarly situated" firm can be used to prevent competitors from being disadvantaged relative to one another, it is preferable to use benchmarks that do not include "hold-up" where a patent holder charges an excessively high royalty.[4] The general theoretical concern with hold-up in the context of standard setting is that, while a firm may have alternatives to using a patented technology prior to a standard being set, once a patented technology is included in the standard the firm may no longer find those previous alternatives to be commercially feasible. The patent holder may be able to exploit the elimination of those alternatives and "hold up" the firm. That is, hold-up can potentially occur when the standard-setting process eliminates competing alternatives, thus creating or enhancing the market power of a patent holder.

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[2] *See* FTC, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition,* March 2011 (hereinafter *FTC Report*), p. 192. We are not aware of any difference between Reasonable and Non-Discriminatory ("RAND") and Fair, Reasonable and Non-Discriminatory ("FRAND"). To avoid confusion, we will use the term FRAND throughout this paper.

[3] Dennis W. Carlton & Allan L. Shampine, *An Economic Interpretation of FRAND*, 9 J. COMPETITION L. & ECON. 531 (2013).

[4] We provide a more detailed discussion of hold-up and the definition of "similarly situated" in Carlton & Shampine 2013, *id*.

This enhancement of market power may also occur when a licensee makes sunk investments specific to the standardized technology before it negotiates a license, thus worsening its bargaining position. To use a simple two-party example: Suppose that a Manufacturer could build a factory using one of two equally good technologies (A or B). In either case, building the factory costs $11 million. It chooses technology A without knowing that it will need a patent license from Patent Holder. Patent Holder then comes along and says, "Now that you've built that factory, you must either pay me a royalty of $10 million or build a new factory that doesn't use my technology."[5] The Manufacturer thinks, "I wish I had known that before I built the factory, because then I would have used technology B, which is available to me for less. But rather than have to build a new factory that would cost $11 million, I will agree to pay the $10 million royalty for a license to A." This is an example of hold-up.[6]

There are three categories of license that are likely to provide benchmarks that are substantially protected against hold-up. First, when a licensee has a legally enforceable right to "reasonable" terms, then license negotiations occur with the recognition that the licensee has the option to challenge the offered terms in court rather than signing the offered license, if it does not believe those terms to be reasonable. The terms in licenses negotiated in such circumstances may be expected to be "reasonable" within the meaning of the patent holders' contractual FRAND obligations and any similar competition law requirements, determined by the cost of litigating to enforce those obligations.

Second, if (i) a patent holder announces non-discriminatory license terms for its patents prior to the adoption of a standard and therefore prior to anyone having sunk investments relying on the standard, and (ii) the SSO then includes those patents in the standard, that is evidence that the SSO regards the terms as reasonable given the value created by the patented invention. The terms do not reflect hold-up from market power created by the inclusion of a patented technology in a relevant standard or from exploitation of sunk costs made in reliance on the standard.

Third, license terms are also protected against hold-up if there are actual negotiated rates with prominent and sophisticated firms prior to the standard being set. We discuss each of these categories below.

II. NEGOTIATIONS IN THE PRESENCE OF THE LAW

When patent licenses are negotiated where there are legally enforceable "reasonableness" requirements (whether contractual or statutory), the terms of those agreements may generally be expected to be "reasonable" within the legal meaning of those requirements, as long as litigation costs are low relative to the total royalties. We explain further below.

Firms often make contractual commitments to SSOs to license patents essential to standards of those SSOs on FRAND terms.[7] These commitments are public, and we understand

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[5] The investment made in building the factory is called a "sunk cost."

[6] As our example illustrates, the potential for "lock in" created by sunk costs is not limited to the standards context. Note also that a patent holder has also sunk costs in R&D and may itself feel exploited, or "held up," under some circumstances.

[7] *See*, for example, Carlton & Shampine 2013, *supra* note 3.

that the contractual FRAND commitment is generally viewed as legally enforceable in any jurisdiction appropriate to a particular dispute. Firms can, and do, sue to enforce such commitments in court, or use such commitments as defenses against patent infringement actions. Table 1 provides examples of cases brought before a variety of courts in which a party sought to enforce a contractual commitment to license on FRAND terms.

Table 1. Examples of FRAND-Related Contract Litigation

AmTran Technology Co., Panasonic, Toshiba, Vizio & ZTE (U.S. International Trade Commission, No. 337-TA-884)
Apple v. Motorola Mobility (Germany, Mannheim Regional Court, No. 7 O 122/11)
Apple v. Samsung (Australian Federal Court, No. NSD315/2013)
Charter Communications et al. v. Rockstar Consortium (U.S. District Court, District of Delaware, No. 14-cv-55)
Ericsson v. D-Link et al. (U.S. District Court, Eastern District of Texas, No. 10-cv-473)
Ericsson v. Samsung (U.S. District Court, Eastern District of Texas, No. 12-cv-894)
Microsoft v. Motorola (U.S. District Court, Western District of Washington, No. 10-cv-1823)
Motorola v. Apple (U.S. District Court, Northern District of Illinois, No. 11-cv-8540; U.S. District Court, Western District of Wisconsin, No. 10-cv-662)
Nokia v. Apple (U.S. District Court, District of Delaware, No. 09-cv-791)
Nokia v. Qualcomm (Delaware Chancery Court, No. 06-509)
Realtek Semiconductor Corp. v. LSI Corp. (U.S. District Court, Northern District of California, No. 12-cv-3451)

Firms may also sue under competition laws of various jurisdictions, or may make complaints seeking to persuade antitrust regulators to start enforcement actions, if the licensee believes that the proposed license terms violate the antitrust regime in a particular jurisdiction. In some jurisdictions, including the United States, antitrust law rarely reaches unilateral pricing by itself. In other jurisdictions, the standards relevant to competition laws may differ from the "reasonableness" standard arising from a contractual FRAND commitment. Nonetheless, suits or investigations based on allegations of unreasonable terms for SEP licenses in violation of antitrust law have occurred in multiple jurisdictions. Some examples are listed in Table 2 below:

Table 2. Examples of Antitrust Litigation and Investigations Related to Allegations of Unreasonable Terms

Broadcom, Texas Instruments, Nextreaming & Thin Multimedia v. Qualcomm (Korean Fair Trade Commission, No. K06673-0601)
Icera v. Qualcomm (European Commission, Nos. COMP/C-3/39.247-252, COMP/C-1/39.711)
Merger investigation - Google & Motorola (U.S. Department of Justice)
Merger investigation - Bosch & SPX (U.S. Federal Trade Commission, No. 121 0081)
Nokia, Ericsson, Broadcom, Texas Instruments, Panasonic & NEC v. Qualcomm (European Commission)
Preliminary Statement of Objections v. Motorola Mobility (European Commission)
Statement of Objections v. Samsung (European Commission, No. COMP/C-3/39.939)

While the examples above show that firms can, and do, take advantage of the legal protections available to them, the *ability* to go to court impacts negotiations even where litigation does not actually occur. This is because a potential licensee, faced with an unreasonable offer, can choose to decline the offer and go to court to seek better terms. The litigation option is always in the background. Sophisticated firms will thus examine the factors that would be considered in litigation, estimate the likely outcome of litigation, and take those considerations into account in negotiations.

For example, firms will examine the factors that courts are likely to look at when evaluating the FRAND commitment with the goal of estimating what a court is likely to conclude are "reasonable" terms. Those factors will then enter into the negotiations. Factors that a potential licensee is likely to consider in deciding whether to accept offered terms or go to court include the following:

- The possibility that patents might be invalid or not infringed.[8]
- The economic "value" of the patents as likely to be evaluated by the court, which could include, for example, the degree to which the patented feature is the basis for customer demand.[9]
- The royalty base likely to be used by a court, and the interaction between that royalty base and the royalty rate.
- The value of any cross-license demanded by the licensor, including its relative value compared to the primary license.
- The scope of the license, including the number and type of patents included.
- Any discrepancies between the terms offered and terms given to other market participants, as potentially indicating that the offered terms are "unreasonable" or "discriminatory."
- The necessity (if any) to obtain licenses from other parties that also hold patents essential to the same standard(s), potentially leading to concerns about high cumulative royalties ("royalty stacking").[10]
- The value of non-monetary terms, including joint research projects, business cooperation, and technical assistance agreements. Such non-monetary terms can be quite complex.

A licensee negotiating royalties where he is protected by a legally enforceable FRAND commitment is in a better position than is a licensee without such protection. In particular, if a patent holder insists on a rate or other terms that a court is likely to find to be unreasonable (or, more generally, terms that a court is not likely to find reasonable), then the licensee has the option and a strong incentive to go to court rather than accept any such terms (and, as noted

[8] Noninfringement is a possibility even for patents that have been declared as potentially essential to a standard, as there can be uncertainty or disagreement about whether a patent is, in fact, essential to a standard.

[9] *See*, for example, Lucent Techs., Inc. v. Gateway, Inc. 580 F.3d 1301, 1336-37 (Fed. Cir. 2009).

[10] We describe why licensees may care about royalty stacking in Carlton & Shampine 2013, *supra* note 3, at 542.

earlier, firms can and do exercise this option).[11] If a court ruling is obtained, that of course reveals what that court believes to be "reasonable" under the FRAND contract, in light of whatever evidence the parties may submit. On the other hand, if a license is negotiated without litigation (or through settlement of litigation before a ruling is obtained), this indicates the licensee expects that the agreed-upon terms are in the range that a court would likely find reasonable.

If litigation costs were very large relative to the value of the terms being negotiated (i.e., if the costs of litigation were large relative to the potential benefits), then going to court would be an unattractive option, and thus would provide less protection against hold-up.[12] However, if the cost of litigation is small relative to the overall value to be paid under the license, this is likely not a significant concern. Even if some potential benchmark licenses appear less useful because the licensees' litigation costs are likely high relative to the value to be paid, so long as there are some where the litigation costs are relatively low, then there will still be benchmarks allowing the non-discrimination provision in FRAND to work effectively. Indeed, a single benchmark free of hold-up can be sufficient.

Licensors and licensees sometimes negotiate "whole portfolio" licenses that include both SEPs and non-SEPs. In such a case the non-SEPs are not covered by contractual FRAND commitments. One may ask whether such "whole portfolio" licenses are still subject to the protection provided by a legally enforceable FRAND commitment described above. The answer is that if the licensee has the option of demanding a SEP-only license then the licensee still benefits from protection provided by the enforceable FRAND commitment. Specifically, if the licensee believes that the offered terms represented hold-up, and were being demanded based on the essential nature of the SEPs within the portfolio, it could demand an SEP-only license.[13] Then, the licensee could challenge the offered SEP-only terms in court if it believed those terms to be "unreasonable" in violation of the FRAND commitment.

This option provides a constraint on the negotiations even if the licensee does not choose to exercise the "divide and challenge" option. That is, "whole portfolio" licenses are also negotiated with the protection of the court available. However, such licenses are most useful as benchmarks in negotiations for other "whole portfolio" licenses, as it is not necessary then to attempt to unbundle the terms of the license between the SEP and non-SEP portions of the portfolio.

III. PREANNOUNCEMENTS

Even when there is no FRAND commitment by the patent holder, firms are protected against hold-up if a benchmark is used that is created by a preannouncement of non-

[11] This is not to say that the existence of the commitment will itself mean that negotiations will never violate that commitment. The fact that litigation occurs, as noted earlier, is evidence that patent holders are sometimes viewed by licensees as attempting to violate their FRAND commitments. It may also be a sign that the law is not clear, leading to different assessments among the parties of what a court is likely to find to be reasonable.

[12] Litigation costs can potentially deter some suits even when it is in the interest of industry members as a whole to have them resolved. As with all litigation, there may thus be an externality from a precedent-setting case.

[13] The licensee could choose either not to use the non-SEPs or could negotiate separately for them. In such a separate negotiation, the patent holder could not hold up the licensee based on the standard essential nature of part of the portfolio.

discriminatory terms that the relevant SSO believes will be available after the standard is set.[14] Returning to our example of hold-up, if Patent Holder had told Manufacturer up front that the royalty would be $10 million, then Manufacturer would choose which type of factory to build in light of the royalty. We assumed earlier that the two technologies were equally good, but if technology A were, in fact, more valuable than technology B, then Manufacturer would compare that value to the royalty, and would only use technology A if the patented technology was worth at least that much to Manufacturer relative to using technology B. Manufacturer cannot be held up in this situation so long as the announced terms are adhered to.

In the standard-setting context, when a patent holder announces the non-discriminatory terms that it will offer if its patent is included in the standard, then the fact that an SSO adopts those patents into the standard in full knowledge of the terms is evidence that the decision-making SSO members regard those terms as reasonable—not exercising hold-up. It is important in this respect that the terms announced be non-discriminatory; it is not sufficient that they just be preannounced. This is because there is a possibility of strategic action through which a group within an SSO sets rates that disadvantage other members or future entrants.

For example, a patent holder could announce prior to the standard being set that it would charge existing members of the SSO low rates, but would charge any future entrants very high rates. Such terms might well be accepted by the SSO members, but would still subject future firms to hold-up. This situation can be avoided by making the terms generally available and non-discriminatory.[15] Thus, knowledge of the non-discriminatory terms up front can provide protection against hold-up.

IV. LICENSES NEGOTIATED PRIOR TO A STANDARD BEING SET

An equivalent situation would result if, instead of preannouncement of terms to all firms, the patent owner prenegotiated terms with only some firms (i.e., negotiated some licenses prior to the standard being set), and these terms were then announced in a way believed by the SSO to be credible as to its intention to offer non-discriminatory terms to all firms.[16] Or, equivalently, the patent owner prenegotiated terms with firms that were able to influence the standard-setting process so that an alternative technology would be chosen if the patent holder tried to hold them up with unreasonable prenegotiated terms, whether or not those terms were announced at the time.[17] Again, as long as firms that can influence the standard can determine, prior to the standard being set, the terms that would be offered if the patent were to be adopted into the standard, then there can be no hold-up.

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[14] By preannouncement, we mean prior to a standard being set, costs being sunk, and alternatives being eliminated.

[15] We discuss this issue in more detail in Carlton & Shampine 2013, *supra* note 3, at 546-547 and, in particular, how the term "non-discriminatory" should be interpreted. *See also* Richard J. Gilbert, *Deal or No Deal? Licensing Negotiations in Standard-Setting Organizations*, 77 ANTITRUST L.J. 855 (2011).

[16] Preannounced terms can provide a hold-up free benchmark if the SSO adopts the technology with the expectation that those terms would remain available after the standard is set. Such an expectation may be present if the preannouncement is made in a legally binding way (for example, pursuant to a FRAND commitment), but may also be present in other circumstances where the preannouncement is viewed as credible by the SSO members, e.g., the patent holder may have a reputation for abiding by such statements.

[17] Of course, to be an effective benchmark, the terms must be known at some point.

One might assume that any negotiation occurring prior to the standard being set would result in license terms free of hold-up. However, that is not necessarily the case. The key element here is that the firms negotiating prior to the standard being set are able to fully enjoy competition between alternatives. A firm that could not influence the standard-setting process would be unable to take advantage of such competition and its license terms would thus not provide a useful benchmark. However, even small firms may be able to plausibly influence the standard-setting process. If, for example, a patent holder attempted to charge a small firm a very high licensee fee, the small firm could inform other members of the SSO who might then take that behavior into account.

Similarly, one might assume that any negotiation occurring after the standard being set might be subject to hold-up. Again, that is not necessarily the case. For example, new entrants enjoy at least some protection as they cannot be held up over sunk costs that they have not yet incurred, although they could still be subject to having fewer alternatives available than prior to the standard being set. Such negotiations with new entrants can therefore provide some information about useful benchmarks, but terms negotiated by prominent firms prior to the standard being set are preferable. There may also be situations where hold-up is unlikely or limited because the standard itself has close substitutes.[18]

V. COMPLICATIONS

Even once benchmark licenses free of hold-up have been identified, there may still be practical difficulties to the extent that the scope of the licenses differs. For example, we may observe a set of licenses each covering multiple standards, but where the specific standards vary between licenses, or where both standard essential and non-standard essential patents are included. For the latter, these still may serve as useful benchmarks because the "shadow of the law" protection still applies so long as the licensee has the option to unbundle (e.g., could sue to obtain a license strictly for the FRAND-covered IP), and, particularly outside of litigation, where potential licensees may prefer to obtain broad licenses and so be interested in benchmarks for such licenses.

It may also be possible to implicitly unbundle broad licenses when there are multiple licenses made up of different components. For example, if the licenses are covering standards A, B, and C, and we observe licenses for A/B, B/C, and A/C, then we can determine the implicit terms for each standard separately (assuming that those terms do not vary significantly across customers).

Similar problems can arise when possible benchmark licenses are exclusively cross licenses. Again, it may be possible to implicitly unbundle the elements by comparing overlapping licenses. To take a simple example, assume that Firms A, B, and C each have cross-licenses with one another, and each cross-license involves a single lump sum payment. We would like to know the value of each portfolio. The payment, however, gives us only the net value.[19] So if A is paying

[18] Even in these situations, the possibility of royalty stacking may make it difficult to use a license as a benchmark if, for example, there are multiple patent holders, but the potential benchmark license is for a single patent holder who has extracted most or all of the available rents.

[19] The payment itself may vary between fixed fees and running royalties. Comparing the two may be done by, for example, estimating the expected sales volumes at the time of the negotiation.

B, we observe only the degree to which the value of A's portfolio exceeds B's. But with cross-licenses between A/B, B/C, and A/C, we have three equations in three unknowns, and can solve for the values of A, B, and C. Thus, if those values were $100, $75, and $50, respectively, we would observe cross licenses with payments of $25 from B to A (because A – B = $25), $25 from C to B (because B – C = $25), and $50 from C to A (because A – C = $50). Obtaining the actual values is then a matter of simple substitution.

The process may also be more complicated when the terms contain running royalties, other forms of consideration, or the value varies depending upon the partner (i.e., B and C may not be similarly situated). In principle, however, the same process can be applied based on the firms' expectations as to what sales would be, with any appropriate adjustments for risk, though such adjustments may be complicated.

VI. CONCLUSION

This paper has shown how even when royalty rates for patents are not set in advance, FRAND terms can protect members of an SSO and that this protection can be implemented by using various benchmarks.

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Cuffs and Compliance: A 5-year Retrospective of Criminal Anti-Cartel Competition Law Enforcement in Canada

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Cuffs and Compliance: A 5-year Retrospective of Criminal Anti-Cartel Competition Law Enforcement in Canada

Grant LoPatriello [1]

I. INTRODUCTION

Enforcing the criminal anti-cartel provisions of Canada's *Competition Act* (the "Act")[2] has been a dynamic undertaking for the Competition Bureau (the "Bureau") over the last five years. However, despite the significant transformation to the landscape of both the Act itself and the *Criminal Code*,[3] the Bureau's willingness to vigorously and consistently enforce the Act's criminal anti-cartel provisions remains unwavering. This short article examines the dynamism of criminal anti-cartel competition law enforcement in Canada from 2009 to present and highlights a number of significant changes in the law and policy that have shaped that landscape.

II. LEGISLATIVE CHANGES

In what was arguably the most significant change affecting criminal anti-cartel competition law enforcement in Canada in more than a century, the *Competition Act* was amended in 2009[4] to alleviate the prosecution from satisfying an onerous economic test under section 45—the Act's price-fixing, market allocation, and output restriction prohibitions. The test required the prosecution to prove an undue lessening of competition on the criminal standard: beyond a reasonable doubt. Among other things, the test had been described as "the greatest obstacle to a successful conviction"[5] under section 45.[6] Accordingly, a *per se* criminal offense was introduced to replace the test, and to better address this egregious anticompetitive conduct.

In 2009, the Act was also amended to increase the liability associated with these criminal offenses. Indeed, the maximum penalty for an offence under section 45 increased from a term of imprisonment not exceeding five years to a term not exceeding 14 years, and from fines not exceeding C$10 million to fines not exceeding C$25 million.

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[2] R.S.C. 1985, c. C-34.

[3] R.S.C. 1985, c. C-46.

[4] The current section came into force in March 2010. Conduct carried out prior to March 2010 is assessed pursuant to the criminal provision that existed at the time.

[5] Parliament, House of Commons Standing Committee on Industry, Science and Technology, *A Plan to Modernize Canada's Competition Regime*, 8 OFFICIAL REPORT OF DEBATES (HANSARD) 94 (9 April 2002).

[6] *See* also Robert S. Russell, Adam F. Fanaki, & Davit D. Akman, *Legislative Framework for Amending Section 45 of the Competition Act*, BORDEN LADNER GERVAIS LLP 61 (11 April 2001).

These increased penalties are consistent with the maximum penalties for other serious offenses under the *Criminal Code*, such as fraud. As Crampton C.J. suggests in obiter in *R. v. Maxzone Auto Parts (Canada) Corp.*,[7] "price fixing agreements, like other forms of hard core cartel agreements, are analogous to fraud and theft. They represent nothing less than an assault on our open market economy."[8] Moreover, "price fixing and other hard core cartel agreements therefore ought to be treated at least as severely as fraud and theft, if not even more severely than those offences." [9]

Accordingly, the magnitude of these increased penalties has not only served to underscore the egregiousness of these offenses, but has also increased one of the incentives for parties to seek lenient treatment and, where available, immunity. In a similar vein, the maximum penalty for bid-rigging increased from a term of imprisonment not exceeding five years to a term not exceeding 14 years. Fines imposed at the discretion of the Court remain unchanged for rigging bids.

Another significant change has impacted the legislative landscape of criminal anti-cartel competition law enforcement in Canada. The *Safe Streets and Communities Act*[10] amended the *Criminal Code* in 2012 to eliminate reference to "serious personal injury offences" and has restricted the availability of conditional sentences for offenses for which the maximum term of imprisonment is 14 years or life. In other words, the *Criminal Code* no longer permits judges to impose conditional sentences, such as community service or house arrest, on individuals found guilty of an offense under either section 45 or 47 of the Act. Instead, the Court is obligated to impose a custodial sentence. As will be discussed in more detail below, this important amendment has contributed to the Bureau's rigorous approach to criminal law enforcement.

III. RIGOROUS APPROACH TO ENFORCEMENT

The foregoing legislative changes signal the seriousness of white-collar crime and the Government of Canada's eagerness to eradicate it. If the Bureau obtains evidence that implicates individuals in criminal anticompetitive conduct, it has indicated that it will not hesitate to recommend to the Public Prosecution Service of Canada (the "PPSC"), where appropriate, that those individuals be charged. The Bureau has also indicated that while it understands that its rigorous approach may result in a greater number of fully contested cases, the recent legislative amendments require an aggressive stance be taken with individuals who are implicated in cartels.

As evidenced by some of the Bureau's recent cases, the Bureau is more frequently recommending jail time for individual conspirators. For example, in the ocean freight shipping case, two individuals received two concurrent conditional sentences ranging from 3 to 4 months and community service ranging from 20 to 30 hours. In June 2013, charges were laid against three individuals for their alleged role in fixing the price of chocolate confectionary products in Canada between 2002 and 2008. And, more recently, criminal charges were laid against seven individuals in two cases involving public procurement.

[7] 2012 FC 1117.

[8] *Id*. at ¶54.

[9] *Id*. at ¶56.

[10] S.C. 2012, c. 1.

Further, in the retail gasoline sector, one of the accused corporations was found guilty at the conclusion of a fully contested section 45 case.[11] The Quebec retail gas investigation is significant not only because 39 individuals had been charged, but because the Superior Court of Quebec made a pronouncement on section 22.2 of the *Criminal Code*—finding that a territorial manager was a "senior officer," thereby making the organization party to the offense through the manager's actions.[12]

The Bureau's targeted and principled approach to criminal law enforcement, however, is not limited to investigating individuals. It is continuing to pursue corporate criminals rigorously, both domestically and internationally. In the last five years, the Bureau has charged numerous companies, and has collected more than C$100 million in fines. Of course, the Bureau does not operate in isolation. It enjoys the benefit of its many close relationships with key law enforcement agencies across the globe. At present, Canada has in place more than 35 mutual legal assistance treaties, 50 extradition treaties, and 10 state-to-state cooperation agreements, agency-to-agency arrangements, and memoranda of understanding.

At home, the Bureau has worked closely with domestic police forces and has signed memoranda of understanding or similar agreements with a number of federal and provincial government departments and agencies, including the PPSC and Public Works and Government Services Canada. These memoranda promote cooperation and collaboration by providing for the sharing of information and best practices.

In addition to seeking assistance from other law enforcement agencies—foreign and domestic—the Bureau has signaled that it is committed to using its entire suite of formal tools to detect and investigate cartel activity, including: the Immunity and Leniency Programs, production orders, searches, wiretaps, and requests pursuant to mutual legal assistance treaties. As highlighted in Table 1 below, the Bureau has, in the last five years, successfully sought production orders, search warrants, and wiretap orders to advance almost 20 complex criminal anti-cartel investigations, further demonstrating its commitment to employing these formal powers in a targeted and principled manner. The success in either administering or obtaining these tools is owed, in large part, to the Bureau's strong partnership with the PPSC.[13]

[11] *R. c. Pétroles Global inc.*, 2013 QCCS 4262.

[12] The decision of the Superior Court of Quebec is likely to be appealed.

[13] While the Bureau is responsible for investigating criminal anti-cartel conduct and administering its Immunity and Leniency Programs, the PPSC is responsible for prosecuting alleged offenders, as well as granting immunity and negotiating plea agreements for parties seeking lenient treatment.

Table 1:[14]

	Markers Granted		Formal Powers Exercised			Penalties	
	Immunity	Leniency	Production Orders	Search Warrants	Wire Tap Targets	Convictions Registered	Fines Imposed
2009	9	3	0	5	0	14	15,380,000.00
2010	65	20	0	10	47	5	8,050,000.00
2011	60	40	31	19	3	6	795,000.00
2012	14	12	0	8	0	30	22,533,500.00
2013	95	24	1	27	17	12	46,536,000.00
2014	93	23	0	20	0	6	10,875,000.00
Total	**336**	**122**	**32**	**89**	**67**	**73**	**104,169,500.00**

The Bureau has also signaled that, where appropriate, it is committed to resolving cases by means alternative to prosecution and immunity agreement. Alternative Case Resolution ("ACR") addresses non-compliance, while supporting the effective and efficient use of the Bureau's resources. Types of ACR include: information letters and visits, warning letters, undertakings, and subsection 34(2) prohibition orders. Since 2009, the Bureau has employed numerous ACRs.

These tools, together with the formal powers noted above, enable criminal investigators to conduct their investigations in a manner that is appropriately aggressive to the criminal nature of the conduct at issue.

IV. VIGOROUS APPLICATION OF IMMUNITY & LENIENCY PROGRAMS

The Competition Bureau's Immunity and Leniency Programs continue to be some of the most effective tools for detecting and investigating criminal anticompetitive conduct in Canada. The effectiveness of these programs was demonstrated in early 2013, when two Japanese suppliers of motor vehicle components were fined C$35 million by the Ontario Superior Court of Justice for their participation in bid-rigging conspiracies.

Despite the many successes of these programs, they can present challenges owing to the tension between the timely cooperation obligations and the desire to minimize exposure to criminal convictions and follow-on class actions. In the past, immunity and leniency applicants have not always adhered strictly to their timely cooperation obligation under the programs. The Bureau has taken a vigorous approach in its application of the Immunity and Leniency Programs. It has been guided by the principle that no one has the right to retain the immunity or leniency privilege without delivering on their end of the bargain. In that regard, the Bureau has cancelled markers where there has not been a sufficient proffer of information within that specified timeframe.

[14] These figures are current as at August 1, 2014.

Moreover, marker extensions will only be granted on a principled basis. Parties seeking extensions to complete their proffers should be prepared to provide the following: information on the status of their internal investigation, a detailed proposed work plan for the completion of the proffer, and an update on the status of their cooperation with other agencies.

To solidify the rigor with which the Bureau applies its Immunity and Leniency Programs, it revised the Immunity and Leniency FAQs in 2010 and again in 2013. Although the programs themselves have not changed, the FAQs provide stronger and more precise language on a number of subjects, including markers, fines, and waivers.

V. OUTREACH & TRANSPARENCY

The Competition Bureau strives to be as transparent as possible to provide a level of certainty and predictability in its approach to criminal law enforcement, both for business and the legal community. To that end, the Bureau undertook a great deal of effort (thanks in large part to the cooperation of stakeholders) to introduce and revise guidance on the substantial 2009 amendments, including the *Competitor Collaboration Guidelines*.

Today, the Bureau continues to consult interested parties in developing and refining the policies and procedures that touch upon the administrative and substantive rights of parties during its criminal investigations. Such consultations afford both counsel and their clients certainty in respect of the Bureau's approach to law enforcement.

What is more, the Bureau continues to work closely with other government departments and law enforcement agencies to create awareness of Canada's criminal anti-cartel competition laws, and to promote compliance with those laws. In recent years, the Bureau has delivered outreach presentations to a variety of police forces and anti-corruption officials in Canada.

The Bureau has also made strides to connect with the general public. In Spring 2013, the Bureau announced its Criminal Cartel Whistleblower Initiative (the "Initiative"), publicizing the Act's long-standing whistleblower protections. The Initiative highlights the role of employees in reporting their employer's criminal anticompetitive conduct and explains the criminal sanctions that may flow from any retributive action taken by the employer.

And, on March 24, 2014, as part of Canada's fraud prevention month, the Bureau launched its first annual anti-cartel day, which was aimed at increasing awareness among businesses about how to avoid engaging in cartel activity, such as price-fixing and bid-rigging.

VI. CONCLUSION

Attacking cartels remains a top priority for the Competition Bureau. While the *Competition Act* has transformed significantly over the last five years, its transformations support the Bureau's vigorous and consistent approach to enforcing sections 45 and 47 of the Act in the case of egregious cartel activity.

The vigor of the Bureau is not only evident through its treatment of individuals implicated in such activity, but it is also reflected in the Bureau's steadfast application of its Immunity and Leniency Programs. In order to ensure the effective administration of these programs, the Bureau will continue to collaborate with partners and other interested parties, as such collaboration undoubtedly benefits all Canadian consumers.

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Greece: Diversifying and Expanding Advocacy Efforts and Outreach Activities in View of the Ongoing Financial Crisis

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Greece: Diversifying and Expanding Advocacy Efforts and Outreach Activities in View of the Ongoing Financial Crisis

Dimitris Loukas[1]

I. INTRODUCTION

In recent years, the Hellenic Competition Commission ("HCC") has taken steps to diversify and expand considerably its advocacy efforts and overall outreach activities, both as a result of the ongoing financial crisis and the sustained role of the HCC in promoting structural reforms in the context of Greece's Economic Adjustment Programme. For this purpose, a variety of instruments have been used by the Authority, including: formal opinions—recommendations for legislative change addressed to the government (upon request by the competent line ministries or at its own initiative); targeted screening and regulatory impact assessment initiatives in cooperation with the OECD; and publication of compliance and awareness guides.

II. THE REALIGNMENT OF HCC'S STRATEGY—INCREASED FOCUS ON ADVOCACY

In view of the ongoing financial crisis, there are three main pillars that underpin the strategy of the HCC:

1. Maintaining a consistent level of competition enforcement albeit the crisis, while adapting case allocation and focus;
2. Strengthening market monitoring actions; and
3. Diversifying and expanding considerably competition advocacy and outreach efforts in order to promote structural reforms (pledged in the context of Greece's Economic Adjustment Programme) and increase overall competition awareness.

The HCC currently allocates a significant part of its resources to advocacy functions, focused primarily on identifying and removing regulatory obstacles to competition and promoting a genuine competition culture through outreach activities. During the period 2011 - 2012, advocacy work accounted for up to 25 percent of the HCC's total output. Furthermore, it amounted to 15 percent of total output during the course of 2013, thus maintaining record levels compared with the OECD average.

The main reason that has prompted the Authority's increased focus on competition advocacy has to do with the recent unprecedented economic downturn, which exposed the structural rigidities and inefficiencies of the Greek economy. In this context, the HCC realigned its strategy, so as to increase the exercise of its advisory powers in the field of identifying and removing regulatory obstacles to competition—the objective being to complement our core enforcement work with initiatives promoting structural reforms—while further promoting competition awareness in areas exhibiting a high risk of anticompetitive conduct (as indicated by

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recent enforcement action and ensuing patterns in terms of likely and/or repeated type of infringers).

Two factors contributed to this strategic re-alignment:

- First, the revision of the Greek Competition Act (Law 3959/2011), which gave the HCC the power to issue formal opinions—recommendations for draft legislation potentially affecting competition; and
- Second, specific provisions in the context of Greece's Economic Adjustment Programme agreed between the EU-ECB-IMF and the Greek government, which gave the Authority a special role in promoting certain reforms (notably, in the area of professional services).

Since 2011, the HCC's advocacy and outreach agenda has revolved around four key themes:

1. Liberal professions (liberalization of professional services),
2. Legislative distortions mostly affecting retail and food supply chains,
3. Greece's Competition Assessment Project (an OECD-managed project, in partnership with the HCC, which applied the OECD's Competition Assessment Toolkit in designated sectors of the Greek economy over a period of 10 months), and
4. The publication of competition compliance and awareness guides, primarily addressed to trade associations, as well as procurement/contract awarding public authorities.

III. LIBERALIZATION OF PROFESSIONAL SERVICES

In the context of the MoU signed between the EU-ECB-IMF and the Greek Government, the HCC (as an independent authority) was called upon to issue formal opinions—recommendations with regard to liberalizing several professions. This was an exercise that essentially comprised an extensive review of existing laws and regulations from the point of view of competition, focusing on the entry and exercise of a number of regulated professions.

This prompted the most far-reaching intervention of the HCC in the area of liberal professions (and the most far-reaching intervention ever in terms of regulatory obstacles to competition). During 2011-2012, the HCC's task force on liberal professions reviewed laws and regulations affecting more than 55 regulated professions (ultimately issuing 17 formal opinions). The following year (2013), the HCC issued three new formal opinions aimed at identifying and removing regulatory obstacles as regards the access and exercise of a number of professional services.

Overall, the professional services reviewed by the HCC in this context fell within two broad categories:

The first category included some key regulated professions, such as lawyers, accountants, and engineers, which were addressed specifically by Law 3919/2011. In particular, this legislation, which was a significant component of Greece's action plan on structural reforms: (1) provided for the horizontal abolition of a number of restrictions affecting all liberal professions, including fixing of fees, geographic restrictions in the exercise of a profession, numerous clausus restrictions (admission requirements), second-establishment restrictions, restrictions on

advertising, etc.; (2) replaced the prior administrative license system (where applicable) with a simple notification and ex-post review system; and (3) included specific provisions for the liberalization of certain key regulated professions, such as lawyers, notaries, chartered accountants, and engineers. For the latter selected professional activities, the HCC issued a number of recommendations, including for example:

- For lawyers: the removal of fixed minimum fees, advertising restrictions, and also territorial restrictions on where lawyers can practice in Greece;
- For notaries: the relaxing of rules on fixed fees and the maximum number of notaries allowed to operate per prefecture;
- For architects/engineers: the removal of fixed minimum fees;
- For chartered accountants: the removal of fixed minimum fees.

The second category included all other liberal professions, where a horizontal approach was opted for by Law 3919/2011. As indicated above, for all those other professional activities, the legislation just provided, in a general way, for the abolition of certain regulatory restrictions (e.g. fixing of fees, numerous clausus & territorial restrictions, etc.) and for the abolition of the prior administrative license system for the entry into and exercise of each profession.

However, it also provided for the opportunity to get an exemption from full liberalization by profession, on the basis of overriding public policy considerations and subject to the principle of proportionality. In this context, the government entrusted the HCC with the task of reviewing all such exemption requests from Law 3919/2011, i.e. requests to maintain and/or re-instate prior authorization requirements and other restrictions regarding the exercise and access to those liberal professions where the horizontal liberalization approach had been applied. In this regard, the HCC applied the key methodology of the OECD Competition Toolkit and/or similar competition impact assessment techniques, notably by assessing and weighing public policy considerations in the light of the principle of proportionality. By way of example, the HCC reviewed exemption requests pertaining to the following professions:

- Chartered (sworn-in) appraisers/valuers;
- Actuaries;
- Accountants;
- Tax consultants;
- Geotechnicians (including the production and marketing of propagating material and fertilizers);
- Licensed providers of services relating to public security and public safety;
- Tourist guides;
- Licensed providers of educational services;
- Licensed providers of health-related services; and
- Licensed sellers of tobacco products

The intensity of HCC's review varied according to the conditions prevailing in each professional activity. In certain cases, the Authority's recommendations were tailored-made as to correspond to the specific exemption request made, while in other cases the HCC opted for issuing wide-ranging recommendations (essentially comprising an overhaul of the way a certain professional activity is organized and performed).

The opinion concerning chartered (sworn in) appraisers/valuers is an example of the latter approach. In their request for exemption, chartered appraisers asked to maintain: (i) the limited access to the profession (numerus clausus), (ii) the exclusive rights to provide certain valuation services, (iii) the prohibition in the exercise of the profession by legal entities or other EU nationals, and (iv) their fixed remuneration. In doing so they claimed overriding public policy considerations, such as the protection of consumers and the effectiveness of the tax collection system.

However, in its opinion-recommendations addressed to the government, the HCC found that these claimed public considerations were not substantiated and, in any event, did not comply with the principle of proportionality. The HCC, therefore, recommended that all such restrictions should be lifted. Furthermore, after reviewing the conditions of entry into, and exercise of, this professional activity, the HCC further proposed, *inter alia*, that the professional base of the appraisers' organization be substantially broadened based on transparent and objective criteria, either with the admission of all natural and legal entities having equivalent vocational qualifications or, alternatively, by accrediting additional (and competing) professional associations. The HCC also recommended that a registry of certified appraisers be created (by specialty).

Moving forward, the HCC will actively participate in a follow-on project coordinated by the Ministry of Economy (planned for autumn 2014), aimed at reviewing the qualifications and other requirements for entry into a number of regulated professions, with a view to lifting unnecessary restrictions and overall simplifying access.

IV. OTHER INITIATIVES REGARDING REGULATORY DISTORTIONS MOSTLY AFFECTING RETAIL AND THE FOOD SUPPLY CHAIN

Aside from the above exercise of its consultative powers under the new Competition Act, and in the context of Greece's Economic Adjustment Programme, the HCC has pursued additional initiatives to promote a genuine competition culture. These advocacy initiatives have mostly targeted regulatory distortions affecting retail and the functioning of the food supply chain, but also have had a broader educational function.

For example, the HCC issued recommendations focusing on:

- The reform of the so-called Product and Market Regulation Code, in particular by (a) abolishing all delegation powers concerning minimum and/or fixed prices, export bans and/or export restrictions, as well as transportation fees, and (b) retaining certain delegation powers to regulate the conditions for the sale and marketing of certain products only to the extent they are in conformity with EU regulations;
- The abolition of a regulation obliging that all types of milk (formulas) for babies under the age of six months be sold exclusively through pharmacies;

- The abolition of an obligation imposed on companies to notify regularly their wholesale price lists to the competent line ministry; and
- The removal of regulatory obstacles impeding effective competition in the fuel and the cement sectors.

Most of these recommendations were ultimately adopted and implemented by the Greek government.

V. GREECE'S OECD COMPETITION ASSESSMENT PROJECT

2013 also saw the successful completion of the most intense advocacy project in recent years, Greece's OECD Competition Assessment Project. During the course of 10 months, a core project team comprising competition experts from both the OECD and the HCC undertook an assessment of the costs and benefits of regulations potentially restricting competition in four designated sectors of the Greek economy, namely:

- Retail trade,
- Food processing,
- Building materials, and
- Tourism.

The objective of the project was to evaluate existing regulations and propose alternative (less restrictive) regulations, in order to increase competition and bring about longer-term gains to productivity and economic growth.

Using the methodology set out in the OECD's Competition Toolkit, the team of experts reviewed more than 1,000 pieces of legislation, ultimately identifying 555 problematic regulations and making more than 320 recommendations on legal provisions that should be amended or repealed.[2]

The HCC's partnership with the OECD on this project is a testament to the Authority's capabilities and commitment in further strengthening its advocacy role.

Following the successful completion of the project, a new round is envisaged to commence in autumn 2014, focusing on four additional sectors of the Greek economy. The HCC will also contribute to this follow-on project, in cooperation with the OECD.

VI. COMPETITION COMPLIANCE AND AWARENESS GUIDES & OTHER OUTREACH ACTIVITIES

In the course of 2012, the HCC also undertook the initiative of publishing a new competition compliance guide specifically addressed to trade associations. This initiative is currently being complemented by a series of speeches and workshops undertaken by the Authority in cooperation with interested professional associations, the aim being to promote awareness of competition law and of the benefits of effective competition as a whole.

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[2] *See* http://www.oecd.org/greece/greececompetitionassessment.htm.

The HCC's advocacy focus on trade associations follows a relatively high number of infringement decisions issued in recent years concerning collusive practices by trade associations and other professional bodies. This appears to be a Greek particularity as compared to most other EU Member States. It comes, however, as a direct result of the disproportionate number of self-employed professionals and of the intra-profession protectionist culture still widespread in services markets. The Authority's outreach efforts in this regard aim to promote a genuine competition culture and encourage self-regulation that respects competition rules.

A new guide specifically addressed to public procurement/contract awarding entities is currently under preparation, particularly focusing on practical examples and methods to detect and/or avert bid-rigging. As indicated by recent enforcement action and ensuing patterns, this is an area that increasingly exhibits a high risk of anticompetitive conduct, thus the need to engage in focused outreach activities by the Authority.

Moving forward, the HCC plans to cooperate closely with the Secretariat of the Government in an attempt to promote a coherent Regulatory Impact Assessment ("RIA") strategy at the central administration level. In this context, the Authority will be publishing competition-specific guidelines for the assessment of laws and regulation by the competent line ministries—competition being a significant component of RIA.

VII. CONCLUDING REMARKS

Practitioners are not always happy when we allocate a significant amount of our scarce resources to advocacy and outreach work. However, one needs to recall that the HCC's efforts in this regard have taken place against a backdrop of the longest and steepest recession in the history of the European Union, with the Greek economy contracting for the sixth consecutive year in 2013 (a cumulative drop in real GDP of more than 20 percent since the inception of the crisis, coupled with record levels on unemployment). Several studies suggest that economic recovery in Greece has been partly hampered by the prevailing situation in product and services markets, which remain among the most strictly regulated in the OECD area. Therefore, structural reforms, particularly in the context of professional services, are—in the Authority's view—a necessary precondition for overcoming the constraints imposed by the crisis, for building competitive industries that can withstand international pressure, and, ultimately, for sustaining a new growth model that realizes the economy's productive potential.

The HCC's recent experience from advocacy and other outreach efforts speaks plainly about the urgent need to change the way we legislate, the need to pursue efficient outcomes that reflect the general public interest, and the need to move away from favoring the interests of certain professional groups and other vested interests. Finally, it also speaks plainly about the need to implement a coherent RIA strategy at the level of central administration to sustain the significant progress made thus far in promoting reforms.

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Interactive Guidance and Other Outreach Efforts by the Swedish Competition Authority

Johanna Bjurling & Johan Sahl
Competition Authority of Sweden

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Interactive Guidance and Other Outreach Efforts by the Swedish Competition Authority

Johanna Bjurling & Johan Sahl[1]

I. INTRODUCTION

How do you give accurate, simple, and useful guidance in an area of competition law where the knee-jerk answer to most questions tends to be: "It depends"? This was the challenge the Swedish Competition Authority ("SCA") set itself when we decided to develop a web-based interactive guidance for companies wishing to collaborate in procurement. Our primary focus group was small and medium sized enterprises ("SMEs") with none or little previous experience in competition law. A few months later the project was completed and launched in tandem with a road-show at various industry organizations.

The purpose of the guidance was to offer clearer guidance on when, and in what circumstances, companies are allowed to cooperate when tendering for contracts in a procurement context. Perhaps due to the sparse case law on the subject both in Sweden and at EU level, the SCA had seen signs that companies as well as purchasers often have a hard time identifying where the line is drawn between competitive and anticompetitive cooperation. As a consequence, the SCA has had a number of cases over the last couple of years concerning potentially illegal cooperation, particularly in the context of public procurement. We felt there was a need to couple that enforcement work with more preventive outreach work, assisting companies in this matter at an earlier stage.

So, why guidance on this particular topic, among the countless grey areas of competition law? First of all it is our view that if smaller companies would collaborate in procurements to a greater extent, this could have a positive and strengthening effect on competition. Each year municipalities, county councils, and the government in Sweden procure goods and services for over SEK 500 billion (approximately EUR 55 billion). A large part of the private sector also chooses to procure by some form of bidding procedure. Often large and established companies have an advantage when competing for these contracts. In larger procurements, only a few players in the market may have the capacity to bid independently. Cooperation between smaller companies could be a way for them to submit tenders in procurements and thereby strengthen competition throughout markets.

Secondly, SMEs are less likely to have access to in-house or even external competition law expertise. This may lead to inadvertent breaches of the rules in some instances, but also to over-prudence in other cases. Providing clearer guidelines could therefore encourage pro-competitive collaboration in sectors where SMEs could compete with larger businesses. The purpose of the

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[1] Johan Sahl is Deputy Head of Unit and Johanna Bjurling is a Case Officer at the Cartels and Mergers Unit, Swedish Competition Authority.

initiative is to encourage cooperation, which means more competition for contracts while discouraging collaboration reducing such competition.

II. A WEB-BASED INTERACTIVE GUIDANCE

The SCA's web-based interactive guidance can be used by both procurers and companies and focuses on frequently asked questions—from the specific "Can we cooperate in this particular tender?" to the more general "What forms of cooperation are permitted?" and "When am I allowed to use a competitor as subcontractor?." The user is also informed of what the consequences of illegal cooperation might be.

Throughout the guide "pop-ups" appear where the user can get more detailed information about the specific question or examples based on real cases. The user can choose different levels of details; from short informative answers to more extended information and up to complete versions of court decisions for those wishing to get the full picture. Finally, the user gets an indicative answer on whether the situation in question is likely to be permitted or not. The guidance also stresses, however, that in case of any uncertainty the user should seek legal advice.

The reason why we chose the interactive guidance tool for this outreach initiative is that we have positive experiences of a previous project using web-based guidance. In that case the topic was activities of trade associations, focusing primarily on exchanges of information. That guidance has drawn positive feed-back, not only from companies, but also from lawyers and other practitioners.

An advantage with an interactive guidance, in addition to its easy-to-use Q&A-format, is that it only takes a few minutes to get acquainted with the applicable rules, at least at a basic level. SMEs considering cooperating in a procurement are now able, in advance, quickly, and anonymously to find out whether their cooperation is in accordance with the rules, or if they should act differently.

Since the interactive guidance was published last year, it has been marketed in different ways; during seminars and conferences, as well as in our regular contact with companies and procurers. Even though there are no formal statistics due to the anonymous nature of the guidance tool, the SCA strongly believes that the guidance is a helpful tool for SMEs without prior experience with competition law. For anyone interested, both guidance tools can be found in Swedish at the SCA's website, www.konkurrensverket.se/vagledning.

III. OTHER EDUCATIONAL AND OUTREACH EFFORTS

In the last *Antitrust Chronicle* issue devoted to educational and outreach efforts, the SCA's Chief Economist Arvid Fredenberg wrote about our annual conference, "Pros and Cons," which consistently attracts a range of high-caliber speakers on competition economics.[2] The latest Pros and Cons conference was held in Stockholm in December 2013, on the topic "The

[2] Arvid Fredenberg, *Ten Years of Pros and Cons Conferences*, 8(1) CPI ANTITRUST CHRON. (August 2012). The article is *available at* http://www.kkv.se/upload/Filer/Forskare-studenter/ProsCons/Competition_Policy_Internationals_Antitrust_Chronicle_Sweden_Aug-12.pdf.

Pros and Cons of Counterfactuals." This year's topic is "The Pros and Cons of Antitrust in Two-Sided Markets."

Another example of the SCA's educational efforts is a "checklist" and a related brochure primarily aimed at procurement officials but also for private companies procuring by bidding processes. The checklist sets out twelve signs that suggest that companies may have formed a bid-rigging cartel. The purpose of the related brochure, which explains the twelve signs in further detail, is to increase procurers' awareness that they can actually conduct better business by using the checklist and by being observant. Of course, if a procurer finds indications of a bid-rigging cartel, the SCA also encourages them to contact us. During the development of the checklist, we were inspired by similar products by other organizations such as the OECD and other competition authorities around the world. The SCA's checklist and brochure have been handed out to procurement officials all over Sweden and can also be found on our website.

Parallel with the launch of our latest interactive guidance on cooperation in procurement, the SCA underwent some important organizational changes. We are now a larger, reinforced organization which, as of January 2014, is responsible not only for enforcement of the competition and procurement rules but also for procurement support to public procurers and tenderers. This means that the authority handles both advisory support and supervision of procurement matters. The combination of policy, support, and enforcement matters for both competition law and procurement, and the resultant sharing of knowledge and experience between the departments, makes the SCA unique in Europe. It puts us in a strong position to handle matters that straddle the two areas, such as bid-rigging cartels and other forms of cooperation in procurement. Enforcement of infringements is just one of the ways in which we now work.

IV. THE BENEFITS OF EDUCATIONAL AND OUTREACH EFFORTS

The two interactive guidances, the checklist, and the brochure are some of the SCA's recent educational and outreach efforts aiming to raise awareness among companies and in the long term prevent anticompetitive behavior. The combination of all educational and outreach efforts, together with SCA's regular law enforcement, is hoped gradually to increase the number and quality of tip-offs received by the SCA. Even though not every tip-off is detailed enough to let us carry out a dawn-raid, they all add pieces to the puzzle and indicate which markets may merit closer scrutiny.

Since it is part of the SCA's mission to prevent competition problems and inform the public, we engage in different forms of dialogue with stakeholders in addition to the above mentioned approaches. We frequently give presentations and arrange seminars for procurement officials, trade associations, and the public with the purpose of educating them, for instance on how to recognize signs of anticompetitive behavior. In addition, both the SCA's Communications Department and the Cartels and Mergers Unit work extensively and proactively with external communication in various ways. Benefits of these kinds of educational efforts include a more direct communication with stakeholders, which produces the possibility of getting immediate feed-back and initiating a two-way discussion. Furthermore this more direct external communication work provides a way to get to know and understand current activities in various sectors.

The SCA believes that the combination of educational and outreach efforts, together with support, policy, and law enforcement, is the most effective way in order to safeguard and increase competition in Sweden and live up to our vision "Welfare through well-functioning markets."

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Competition Advocacy as a Tool for Promoting Competition Culture and Combating Public Restraint: The Case of Pakistan

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Competition Advocacy as a Tool for Promoting Competition Culture and Combating Public Restraint: The Case of Pakistan

Joseph Wilson, Ph.D.[1]

I. INTRODUCTION

Pakistan is one of the few countries that have had competition legislation since before 1970; in Pakistan the legislation was in the form of the Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance of 1970 ("MRTPO").[2] However, in October 2007, Pakistan promulgated Competition Ordinance, 2007,[3] which repealed the MRTPO; disbanded the Monopoly Control Authority ("MCA"), which had enforced the MRTPO; and provided for the establishment of the Competition Commission of Pakistan.[4]

The MRTPO had been drafted with the objective to prevent undue concentration of economic power in the hands of few, and had substantive provisions that proscribed (i) undue concentration of economic power, (ii) growth of unreasonable monopoly power, and (iii) unreasonably restrictive trade practices.[5] The Competition Ordinance, on the other hand, was promulgated with the following objectives: (i) to provide for free competition in all spheres of commercial and economic activity, (ii) to enhance economic efficiency, and (iii) to protect consumers from anticompetitive behavior.[6] The foregoing triad captures the various facets of the notion "consumer welfare," which is globally recognized as the *raison d'être* for having a competition regime. The Competition Ordinance was, however, a temporary legislation, which run its course in November 2009 but was extended as a temporary competition regime though Competition Ordinance, 2009, and then Competition 2010, thereby lending continuity to the regime since 2007.

In October 2010, Pakistan finally got permanent legislation in the form of the Competition Act, 2010,[7] having the same substantive provisions—and some additional provisions relating to the establishment of the Competition Appellate Tribunal—as introduced by the Competition Ordinance 2007. The Act applies to all undertakings (firms), whether

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[1] Chairman, Competition Commission of Pakistan. The author is a founding member of the Commission since November 2007. He is a member of the State Bar of New York, U.S.A., and also servers on the International Advisory Board of the Loyola University Chicago's Institute for Consumer Antitrust Studies.The views expressed here are the author's alone and are not necessarily the views of the Competition Commission of Pakistan or any of its members.The author wishes to thank Aleezay Khaliq for her research assistance.

[2] Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970 (V of 1970) (Published in the Gazette of Pakistan, Extraordinary, Feb. 26, 1970) ["MRTPO"]. For a commentary on MRTPO *see* Joseph Wilson, *At the Crossroads: Making Competition Law Effective in Pakistan*, 26 NW. J. INT'L L. & BUS. 565 (2006).

[3] Competition Ordinance, 2007 (LII of 2007) (Published in the Gazette of Pakistan, Extraordinary, Oct. 2, 2007) ["CO 2007"].

[4] CO 2007, Sec. 12.

[5] MRTPO, preamble and Sec. 3.

[6] CO 2007, preamble.

[7] The Competition Act, 2010, Act No. XIX of 2010 (Published in The Gazette of Pakistan Extraordinary, Oct. 13, 2010) [hereinafter "The Act"].

governmental or private, and to all actions or matters which have the effect of distorting competition within Pakistan. The substantive provisions of the Act include prohibitions against (i) abuse of a dominant position; (ii) entering into agreements which have the object or effect of preventing, restricting, or reducing competition within the relevant market; and (iii) deceptive marketing practices. It also introduced a sophisticated pre-merger clearance regime.

II. COMPETITION ADVOCACY[8]

For effective discharges of its mandate, a competition agency's ambit extends beyond the enforcement of substantive provisions of competition law. It should focus on advocacy and outreach activities to promote compliance with the law, and

> must also participate more broadly in the formulation of its country's economic policies, which may adversely affect competitive market structure, business conduct, and economic performance. It must assume the role of competition advocate, acting proactively to bring about government policies that lower barriers to entry, promote deregulation and trade liberalization, and otherwise minimize unnecessary government intervention in the marketplace.[9]

And as Timothy Muris wrote:

> Protecting competition by focusing solely on private restraints is like trying to stop the water flow at a fork in a stream by blocking only one channel. A system that sends private price-fixers to jail, but legalizes government regulations to fix prices, has not completely addressed the competitive problem. It has simply dictated the form that the problem will take.[10]

The Act did envisage that combating private restraint in the market is not sufficient, and that it is equally important to review the effects of government regulation and actions. Therefore, in addition to the substantive enforcement provisions, the Act in section 29 gives a specific mandate to the Commission to do competition advocacy. Section 29 is reproduced below for reference:

> 29. Competition advocacy—The Commission shall promote competition through advocacy which, among others, shall include:
>
> a) creating awareness and imparting training about competition issues and taking such other actions as may be necessary for the promotion of a competition culture;
> b) reviewing policy frameworks for fostering competition and making suitable recommendations for amendments to this Act and any other laws that affect competition in Pakistan to the Federal Government and Provincial Governments;
> c) holding open hearings on any matter affecting the state of competition in Pakistan or affecting the country's commercial activities and expressing publicly an opinion with respect to the issues; and

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[8] ICN Advocacy Toolkit prepared by ICN Advocacy Working Group, *Part I: Advocacy Process and Tools:* "competition advocacy refers to those activities conducted by the competition agency which are related to the promotion of a competitive environment by means of non-enforcement mechanisms, mainly through building a congenial relationship with government bodies and by increasing public awareness of the benefits of competition."

[9] THE WORLD BANK, OECD: A FRAMEWORK FOR THE DESIGN AND IMPLEMENTATION OF COMPETITION LAW AND POLICY, Chapter 6, at 93, (1998).

[10] Timothy J. Muris, *Principles for a Successful Competition Agency*, 72 U. CHI. L. REV. 165, 174 (2005) at p. 170.

d) posting on its website all decisions made, inquiries under review and completed, merger guidelines, educational material and the like.

Section 29 gives a three-prong scheme for conducting competition advocacy: (A) by creating awareness in order to promote competition culture, (B) by reviewing policy frameworks for fostering competition, and (C) by giving opinions on matters affecting the state of competition. These are discussed in detail below.

A. Creating Awareness

The Commission has taken a number of measures to create awareness about competition principles and to promote a competition culture. Some of the regular activities under this head are:

1. International Conferences
2. Competition Consultative Group
3. Sessions with Chambers of Commerce
4. Advertisements in Newspapers
5. Seminars
6. Training Sessions
7. World Competition Day
8. Brochures/Booklets
9. Press Releases
10. Compliance through Persuasion
11. Competition Law Course at Universities

1. International Conferences

An important part of the advocacy strategy of the Commission is its International Conferences. The purpose of these international conferences is to create awareness about current competition issues among national stakeholders, and to learn best practices on competition-related issues from international experiences. So far three International Conferences have been organized:

1. The first international conference was held in January 2010 on the theme of "Challenges in Implementing Competition Law in Developing Countries."
2. The second international conference was held in November 2011 on the theme of "Competition Enforcement Challenges and Consumer Welfare in Developing Countries."

As the Commission was in its formative years, these two themes were reflective of an issue that was relevant then.

3. The third International Conference was held in May 2013 on the theme of "Role of Competition in Fostering Trade and Investment," discussing the role of the Commission as Pakistan and the world economy moves towards a more liberalized trade and investment regime.

The Commission is currently planning its 4th International Conference to be held in March 2015. The theme of the conference is "The Role of Competition in Facilitating Economic Revival & Sustainability."

2. Competition Consultative Group

In 2008, to solicit feedback and guidance on competition-related matters from representatives of sector specific regulators, relevant professional bodies, business associations, and the private sector the Commission established an informal think tank called the Competition Consultative Group ("CCG"). The CCG meeting is held quarterly in different cities for wider interaction with the stakeholders. Twenty meetings of CCG have been held so far.

3. Sessions with Chambers of Commerce

The Commission has kept close liaison with the Federation of Pakistan Chambers of Commerce and Industry ("FPCCI"), Overseas Investors Chambers of Commerce and Industry ("OICCI"), Pakistan Business Council, and the American Business Council, among others. One of the more recent advocacy initiatives has been the organization of advocacy sessions across major cities in Pakistan to sensitize the business community about competition law. In the first round, advocacy sessions were held with chambers in Islamabad, Rawalpindi, Lahore, Sialkot, and Multan. These advocacy sessions have proved to be very successful in creating awareness as to the role of the Commission generally, and in the economy.

4. Advertisements in Newspapers

The Commission issued an advertisement "Businesses Beware" in leading national dailies on September 23, 2013,[11] creating awareness as to what constitutes deceptive marketing under Section 10 of the Competition Act. It advised businesses to avoid making unsubstantiated claims.

5. Seminars

The Commission regularly organizes seminars and conferences on various issues. In November, 2013 it held an International Seminar in Karachi, the nation's economic capital, on the theme of "Role of Competition in Improving Investment Climate." The seminar was very fruitful in bringing together professionals from different regulatory authorities and businessmen to discuss competition concerns faced by key industries in the face of the country's difficult economic environment.

6. Training Sessions

The Commission has held a number of training courses for journalists, to help them report properly on competition issues by giving them a basic understanding of the competition principles and the role of the Commission. Training sessions have been also held for the staff of the Commission, in collaboration with the U.K.'s Competition and Markets Authority, under the U.K. Government's IFUSE program.

In addition, the Commission is regularly invited to the workshops organized by the OECD at its Korean regional office. The Commission regularly sends its staff to training sessions

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[11] The advertisement can be viewed on the Commission's website: http://www.cc.gov.pk/images/Downloads/public_notice.jpg

organized by OECD-Korea. The Commission also acted as a host and faculty for a two-day training workshop organized by the U.S. Department of Commerce, in collaboration with the U.S. FTC and the Commission, for the officials of the Afghanistan's Competition Promotion and Consumer Protection Agency.

7. World Competition Day

Over the past two years the Commission has marked the occasion of World Competition Day, on December 5, by organizing a Seminar. Last year the theme of the Seminar was "Economic Growth and Competitiveness." The conference was attended by senior government functionaries, CEOs of private companies, lawyers, and the diplomatic community.

8. Brochures/Booklets

The Commission has prepared a booklet on "protection from anticompetitive practices,"[12] and has issued a number of brochures containing FAQs on topics such as, Competition Act, Voluntary Competition Compliance Code, Leniency Regulations, and Reward Payment Scheme. In addition, FAQs were also issued pertaining to some important decisions of the Commission.[13]

9. Press Releases

The Commission realizes the importance of both print and electronic media in promoting awareness about competition law. The media has been very supportive in this regard. Regular liaison with the print and electronic media helps the Commission in garnering a wide coverage of its initiatives and improving awareness among its stakeholders. In 2013, the Commission issued over 30 press releases.[14]

10. Compliance Through Persuasion

The Commission received a number of complaints regarding tendering conditions floated by National Transmission and Dispatch Company ("NTDC") and Electricity Distribution Companies (DISCOs) for the procurement of electrical equipment. These competition concerns were shared with relevant procurement agencies, highlighting their impact on competition. These agencies, such as SEPCO, LESCO, and NTDC, acknowledged that certain conditions imposed on bidders would restrict competition and therefore agreed to remove/amend such conditions in bidding documents.[15]

In another case, the Institute of Chartered Accountants of Pakistan ("ICAP") increased the examination fee by 118 percent compared to the fee previously charged for final

[12] http://www.cc.gov.pk/images/Downloads/research_and_publications/efn_ccp_protection_from_anti_competitive_practices.pdf.

[13] http://www.cc.gov.pk/index.php?option=com_content&view=article&id=92&Itemid=135.

[14] Press releases can be viewed on the Commission's website: http://www.cc.gov.pk/index.php?option=com_content&view=article&id=97&Itemid=137.

[15] http://cc.gov.pk/index.php?option=com_content&view=article&id=320&Itemid=15; http://www.dailytimes.com.pk/business/04-Feb-2014/tender-for-power-transformers-ccp-ensures-compliance-by-lesco-with-competition-rules;http://www.brecorder.com/money-a-banking/198/1246287/?tmpl=component&print=1&layout=default&page=; http://pakedu.net/pakistan-energy-news/tenders-for-pc-poles-ccp-hails-sukkur-electric-power-company-sepco-for-addressing-competition-concerns/.

examinations. Such an increase in fees appeared to be unreasonable, *prima facie*, violating Section 3 (3) (a) of the Competition Act 2010. The Commission shared this concern with the ICAP; the latter revised the fee structure by reducing the fee by 60 percent, thereby allaying the concerns raised by Commission and the students.[16]

11. Competition Law Courses at Universities

As a member of the Commission, I delivered the first ever Competition Law course at the Law Department of the Lahore University of Management Sciences in Lahore in the winter semester of 2008. Two students from that course later joined the Commission as interns. One of them is still with the Commission, now promoted to the rank of Joint Director. Since then, I have not been able to deliver a full-time course at a university, but do make myself available for lectures, when invited.

B. Policy-notes

The Commission, to date, has issued 17 policy notes (non-binding recommendations) to the government on amending certain laws or policies that have the effect of distorting, reducing, or restricting competition in the relevant market. [17] Recent policy notes include:

1. A recommendation on eliminating the *Discriminatory Levy of Gas Infrastructure Development Cess on selective fertilizer plant,* [18] which the government heeded immediately, and applied GIDC to all fertilizer plants.[19]

2. A Policy Note was issued to the Federal Board of Revenue recommending it withdraw the imposition of a "Capacity Tax" on the beverage industry, which was calculated on installed capacity rather than actual sales. It was noted that a capacity tax is a regressive way of revenue collection and gives undue competitive advantage to those manufacturers who have a high rate of capacity utilization vis-à-vis those who have less demand in market and are not able to fully utilize their installed capacity. Such a discriminatory tax regime stifles competition in the beverage industry and, as a result, small local manufacturers could be forced to close down because they could no longer be able to compete in a tax environment that overwhelmingly favored large manufacturers.

   The Lahore High Court, pursuant to a petition, recently ordered the withdrawal of the capacity tax on the beverage industry. The Court constituted an Economic Commission to determine whether the imposition of a capacity tax had any negative impact on beverage manufacturers. The Economic Commission referred to the Policy Note issued by the Competition Commission and recommended the withdrawal of the tax.

3. A Policy Note regarding amendments in the Bilateral Air Services Agreement between Pakistan and Saudi Arabia ("BASA") was also issued. The Commission took notice of

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[16] http://cc.gov.pk/index.php?option=com_content&view=article&id=345&Itemid=151; http://www.nation.com.pk/business/01-Apr-2014/icap-reduces-ca-examination-fee.

[17] http://www.cc.gov.pk/index.php?option=com_content&view=article&id=21&Itemid=123.

[18] http://www.cc.gov.pk/images/Downloads/policy_notes/gidc_policy_note.pdf.

[19] GIDC: Party over for new plants, http://jsglobalonline.com/researchReports/M03JUL14.pdf; New GIDC rate for fertilizer sector, http://investorguide360.com/latest-economic-news/new-gidc-rate-on-fertilizer-sector-global-research/.

media reports that Pakistan International Airlines ("PIA"), the national flag carrier, was charging exorbitant Hajj fares. In 2008, rates were increased almost by 100 percent, from PKR. 38,500 in 2007 to PKR 70,000 for the South and from PKR 46,200 to PKR 85,000 for North sectors—infringing section 3 (abuse of dominance). The Inquiry Report also noted that the quota sharing agreement between PIA and Saudi Arabian Airline (through their respective governments) infringed section 4 (Prohibited Agreement). Since the governments were involved, enforcement action could not be taken. Therefore, the Commission in 2010 issued a Policy Note to the Government recommending it: (i) abolish any market division, quotas, and payment of royalties, and allow market forces to determine ticket prices without interference from either country's aviation authority or airlines, and (ii) amend the BASA to "allow multiple airlines to be designated by each State to operate direct scheduled services and hajj services between the two countries."[20]

The government amended the BASA, and one airline each from Pakistan (Shaheen Air) and Saudi Arabia (Nas Air) was allowed to fly direct routes between Pakistan and Saudi Arabia. This has fostered entry in the market, thereby increasing consumer choices, and has reduced prices. The fare in 2013 for the south was PKR 87,500 and for the north region was PKR 97,500.[21] Given that 189,000 pilgrims from Pakistan offered *Hajj* last year, and an estimated PKR 40,000 was saved by each passenger (taking into account inflation, increase in jet fuel price, and dollar parity when compared to the prices of 2008), the consumer savings in terms of reduced prices are estimated at PRK 6 billion or U.S.$60 million.

By sharing its advocacy efforts to increase competition in the crucial segment of Pakistan's air transportation market—the route between Pakistan and Mecca—the Commission recently won the World Bank's 2013 Competition Advocacy Contest in the category of "Successfully promoting pro-competition market reforms, opening of markets, and infusion of competition principles in other sectoral policies."[22]

C. Opinion on Individual Matters

In cases where the law or policy is not anticompetitive but its application is affecting the state of competition in the relevant market, the Commission may conduct a public hearing and issue an opinion on the matter. The Commission recently issued an opinion to Oil and Gas Regulatory Authority ("OGRA") and Ministry of Petroleum and Natural Resources ("MPNR") to eliminate discriminatory application of Inland Freight Equalization Margin ("IFEM") asking them to create a level playing field for all refineries and oil marketing companies in crude and refined oil markets.[23]

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[20] http://www.cc.gov.pk/images/Downloads/policy_notes/basa%20policy%20note%20-%2018%20may%202010.pdf.

[21] http://awamtv.com/news/new-hajj-policy-2013-application-in-pakistan/.

[22] https://www.wbginvestmentclimate.org/advisory-services/cross-cutting-issues/competition-policy/winners-2013-competition-advocacy-contest.cfm.

[23] Competition Watchdog asks Petroleum Ministry to end Discrimination, http://tribune.com.pk/story/745723/competition-watchdog-asks-petroleum-ministry-to-end-discrimination/; CCP

III. CONCLUSION

The *Global Competition Review*, a London-based leading international competition law journal, has acknowledged that advocacy activities are just as important as enforcement actions. In its annual Rating Enforcement of the leading competition authorities, it once again gave Pakistan a score of 2.5 stars. The GCR noted:

> Despite further resource cuts, the Competition Commission of Pakistan kept its two-and-a-half star rating this year. A huge surge in the amount of cartel fines issued showed the enforcer remains a serious organisation, and new chairman Joseph Wilson has been very active on the advocacy front both with the business community and with the government.[24]

Competition advocacy is an inherent duty of a competition agency whether or not there is a specific provision, in the competition legislation, mandating it to perform advocacy activities. Advocacy is an ongoing process and must take a central position in the functions performed by a competition agency—both to promote a competition culture, and to combat public restraints.

for Level Playing Field for all OMCs, Refineries, http://www.nation.com.pk/business/08-Aug-2014/ccp-for-level-playing-field-for-all-omcs-refineries.

[24] *Global Competition Review* has published its 14th annual survey of the world's leading competition authorities.

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ICN: Advocacy and Outreach

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ICN: Advocacy and Outreach

Maria Coppola[1]

I. INTRODUCTION

The International Competition Network's commitment to competition advocacy dates back to the network's establishment in 2001, when ICN's founders chose competition advocacy as one of the two areas of focus for the nascent network. Recognizing that public restraints—legislation, regulations, and policies—can have deleterious effects on markets by unnecessarily restricting competition, and that the goal of competition advocacy is to enhance understanding of the competitive process and provide a framework for thinking about public policy issues from a competition perspective, the ICN has dedicated significant resources to developing materials to help competition agencies engage in effective advocacy.[2]

This past year, the ICN broke new ground in adopting recommended practices in the area of competition advocacy when the 127 member agencies approved 13 practices on conducting competition assessments. The first part of this article is devoted to these new recommended practices, followed by a discussion of some of the ICN's other work in the area of advocacy. The second part, in line with the outreach theme of this *CPI Antitrust Chronicle* symposium discusses the network's own tools for promoting outreach to its members and nongovernmental advisors ("NGAs") including a short profile of the ICN's free-of-charge virtual university.

II. RECOMMENDED PRACTICES FOR COMPETITION ASSESSMENT

In creating recommended practices, the ICN seeks to develop consensus recommendations that distill lessons learned from positive experiences as well as from common frustrations and failures, and define a common set of practices that provide clear, tangible guidance to agencies as well as the private sector. In developing them, ICN member agencies work hand-in-hand with NGAs—non-governmental experts including private practitioners, economists, and academics. The proposed practices are vetted first with participants in the working group covering the relevant substantive area (e.g., the advocacy working group). Once the working group and the ICN's Steering Group have approved the proposed Recommended Practices, the Practices are vetted with the ICN's member agencies, and submitted for approval at the annual conference.

To date, the ICN has developed recommended practices in the areas of merger notification and review procedures, merger analysis, and unilateral conduct. At the 2014 annual

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[2] For background on the history, mission, and work of the ICN's advocacy working group, *see* Maria Coppola, *Competition Advocacy and Outreach When All the World Is Your Stage: The ICN Experience*, 8(2) CPI ANTITRUST CHRON. (August, 2012).

conference in Marrakech, the ICN adopted a recommended practice on predatory pricing, as well as the 13 recommended practices on competition assessment discussed here.

A competition assessment—as used in the ICN project—is when a competition agency or another government body evaluates the competitive effects of a proposed or existing policy. Through the competition assessment, policymakers can be urged to consider the policy's likely impact on competition, identify whether justifications exist for any restrictions on competition, and assess whether less restrictive alternatives would achieve the intended public policy goal. By offering policymakers expertise regarding the potential costs of restrictions on competition, competition agencies raise awareness among policymakers and elevate competition as a consideration alongside other public policy goals. Competition assessments can take many forms, ranging from recommendations supported by general economic theory to the more resource-intensive competition impact assessments that seek to quantify an expected impact on prices and competition, with many variations in between.

The ICN's Recommended Practices on Competition Assessment build on the OECD's extensive work on competition assessment, including the OECD Council Recommendation on Competition Assessment and the OECD Competition Assessment Toolkit.[3]

The practices cover the general framework for competition assessment, how competition agencies can create an enabling environment for competition assessment, and how agencies can select policies for competition assessment. For example, the practices discuss the types of restrictions that are most likely to pose the greatest threat to competition, the importance of defining selection criteria by which to prioritize competition assessment among other advocacy activities, and the need to consider the institutional arrangements and relationships with policymakers in identifying a policy for assessment.

For conducting the competition assessment, the practices give guidance about how to begin an assessment as well as factors to consider, such as how the restrictions are likely to influence the market structure and the behavior of firms and customers in the market(s) or in neighboring markets. The practices suggest ways to evaluate the likely impact on competition of a particular policy, ranging from relying on sound economic theory to gathering empirical evidence. Finally, the practices offer ways to deliver the assessment, which can be determinative whether an assessment is accepted or rejected.

The full text of the Recommended Practices is available here: http://www.internationalcompetitionnetwork.org/uploads/library/doc978.pdf.

As a follow on to the adoption of these recommended practices, the Advocacy Working Group now will focus on promotion and implementation. The Working Group plans several approaches to promote the recommended practices: continued discussion of the types of restrictions that threaten competition; network-wide teleseminars, including on the more difficult issues of whether and how to conduct the more resource-intensive competition impact assessments that involve empirical work; and dedicated sessions at an upcoming ICN advocacy workshop, as described below.

[3] http://www.oecd.org/daf/competition/assessment-toolkit.htm.

In a related project, the Advocacy Working Group continues work on how agencies can articulate the benefits of competition for policymakers. A group of members and NGAs are developing an on-line resource of messages and talking points that highlight the value of competition to an economy as well as a compendium of empirical work that supports these messages. The Working Group also has a project to define "competition culture" based on member agency views and identify ways an agency can promote awareness of competition with constituent groups such as the government, the business and legal communities, the judiciary, and the public.

In a few months, the Advocacy Working Group and the Competition Commission of Mauritius will hold a workshop, "*Advocacy: Foundation, Strategies and Assessment,*" open to ICN members and NGAs. The two-day event in early November will examine three topics: (i) establishing an appropriate foundation for advocacy activities, (ii) developing advocacy strategies, and (iii) conducting competition assessments of proposed and existing legislation. In addition to promoting and deepening the new recommended practices on competition assessment, the workshop aims to promote mutual exchange on issues and experiences on the development of advocacy strategies. More information about the event is available here: http://icnadvocacy2014.ccm.mu/English/Pages/default.aspx.

III. ICN'S OUTREACH ACTIVITIES

For novices and experts alike who are new to the ICN, the ICN has outreach toolkits for members and NGAs, designed to provide an introduction to the ICN and its current projects, as well as a catalogue[4] of all ICN work product. For agencies wanting more in-depth assistance understanding or applying ICN work product, the Advocacy and Implementation Network Support Program provides one-on-one assistance. The ICN blog[5] keeps readers abreast of ICN-related events as well as notable developments in member jurisdictions.

An ambitious outreach project the ICN launched three years ago is the creation of a free-of-charge online interactive educational center. In this Curriculum Project, a diverse and distinguished group of agency officials, academics, and practitioners offer competition law and economics training modules, consisting of video lectures and accompanying materials. As part of a similar drive to offer training and promote experience sharing, the ICN holds teleseminars and webinars on a broad range of topics such as advocacy and unilateral conduct.

Virtual University

The ICN, through its Curriculum Project,[6] is creating a comprehensive curriculum of training materials to serve as a free-of-charge virtual university on competition law and practice. Training modules, consisting of video lectures and accompanying materials from a diverse group of member agencies, academics, and practitioners, provide an on-line interactive educational

[4] ICN Work Products Catalogue, *available at*: http://www.internationalcompetitionnetwork.org/uploads/library/doc1002.pdf.

[5] http://www.icnblog.org.

[6] *Available at* http://www.internationalcompetitionnetwork.org/about/steering-group/outreach/icncurriculum.aspx.

center. The Curriculum Project is a primary ICN tool for developing training materials for members and promoting implementation of existing work products.

Thirteen modules have been developed since the project was established. They are organized by subject matter, including: competition policy fundamentals, horizontal restraints, single firm conduct, mergers, competition advocacy, and investigative techniques. Complementing these modules are several short form presentations on discrete topics prepared for the ICN by academics, agency officials, and non-government advisors. In addition, the ICN has collected a virtual library of visual presentations[7] prepared by agencies, academics, and others that may be of interest.

To address resource constraints, the ICN has developed a simplified, short form module format, consisting of a basic lecture by one or two participants similar to an online presentation of a classroom lecture as a complementary model alongside existing modules. These lectures are focused on narrower topics without more elaborate production elements or on screen extras.

For the 2015 annual conference, the ICN plans to develop modules on agency effectiveness, interviewing techniques, and dawn raids and electronically stored evidence, along with short form modules on proof of agreement, merger remedies, and bid-rigging.

IV. CONCLUSION

Through the work of its dedicated Advocacy Working Group, the commitment to promoting its consensus work, and dedication to outreach and training initiatives, the ICN not only is an active advocate for sound competition policy to its member agencies, but also offers something to say about the value of competition to governments, businesses, and the public.

[7] http://www.internationalcompetitionnetwork.org/about/steering-group/outreach/icncurriculum/linklibrary.aspx

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Strategies for Creating and Enhancing a Culture Favorable to Competition

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Strategies for Creating and Enhancing a Culture Favorable to Competition

Sean Ennis[1]

I. INTRODUCTION: SUPERMARKETS UNDER THE SPOTLIGHT

The enactment of a competition law and creation of a competition authority are important elements to ensuring successful operation of economic markets, with businesses vying for the patronage of purchasers through rivalry between their product and service offerings. But the mere existence of an enforced competition authority will not alone set the groundwork of economic competition needed for generating a successful market economy. What is needed is to establish a competition culture, which can be defined as a set of attitudes and beliefs, by the many economic actors that support market outcomes constrained by limits on market power.

The difficulty in establishing a competition culture is not only because of the practical difficulties of enforcing a law—for example, because detecting a violation is difficult or because the number of violations is much higher than the capacity to prosecute them. The challenge is much deeper and more fundamental, lying in standardized forms of interaction and beliefs that may create a culture of ambivalent or hostile attitudes and practices towards competition. In countries that have newly created competition authorities, the challenge of creating a culture in favor of competition can be substantial. While laws may change overnight, traditional behaviors by business operators are unlikely to change with the same speed. Even in countries with a long history of competition law enforcement, values supporting competition can be lacking—not only in the general public,[2] but also among skeptical parliamentarians.[3]

There are a variety of factors mitigating against competition culture, including select societal values, economic rewards, and habits pre-dating competition law. For example, with respect to societal values, from a young age children are taught the benefits of cooperation. For adults, the long-held positive mental associations for cooperation may easily be extended to cartel activity, which is simply one form of cooperation, however nefarious. Even childhood

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[1] Senior Economist, Competition Division, DAF, OECD. 2, rue Andre-Pascal, Paris 75775 Cedex 16, France. sean.ennis at oecd.org. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the OECD or of the governments of its member countries. It draws on contributions from a session during the International Competition Network's Annual Meeting in 2013 and draws more broadly on the competition culture project of the ICN's Advocacy Working Group.

[2] A survey in the United Kingdom found that only 6 in 10 people felt that price-fixing was a serious offense. *See* Andreas Stephan, *Survey of public attitudes to price-fixing and cartel enforcement in Britain*, 5(1) COMPETITION L. REV.123-145 (2008).

[3] Under the United Kingdom's Enterprise Act 2002, s.188, an individual is guilty of the criminal offense if he or she "dishonestly agrees with one or more other persons to make or implement, or to cause to be made or dishonesty requirement leads to few cases being brought due to the difficulties in proving that price fixing is subjectively dishonest." *See* Andreas Stephan, *How Dishonesty Killed the Cartel Offence*, 6 CRIMINAL L. REV. 446-455 (2011).

games may encourage anticompetitive behavior, with one notable example being the game Monopoly® in which the objective is to accumulate geographically local monopolies of hotels and the winner is often the one who has accumulated the most monopolies.

Economic rewards provide further reinforcement to the natural attractions of anticompetitive activities, by making anticompetitive behaviors profitable for the businesses involved. Habits that restrict competition, sometimes pre-dating the establishment of competition law, may also be difficult to change. Businesses and regulators may establish regimes that do not place pressure on businesses to compete aggressively and, even when competition law is understood by business operators, if fines and other penalties are too low, they will not effectively deter anticompetitive activity.[4]

This paper presents a framework of how to promote a more pro-competitive culture by considering different constituencies, what their strengths are, and how to reach them. It is not intended as a complete or comprehensive guide, but as a framework by which key actors can organize strategies, by which useful tools can be identified for different groups, and by which examples of successful competition advocacy can be classified. Tools are identified that can be useful in furthering a pro-market attitude in different communities.

An underlying theme of this discussion is that communication, personal relationships, and quantitative estimates all have an important role to play. The paper concludes by noting that it would be useful to develop measures for the level of competition culture by constituency to help identify the level of competition culture in different countries.

II. CONSTITUENCIES

The question of how to create and enhance competition culture is thus one of broad interest for those who believe in market solutions to the economic problem of producing goods and services and allocating them. This paper outlines a broad array of constituencies for competition culture and then identifies tools that can promote culture with these drivers, laying particular emphasis on the needs of constituencies, the roles they can play, and the tools for activating them.

The thesis of this paper is that competition culture is most effectively promoted by focusing on particular constituencies—their needs and interests—and relevant tools for increasing competition culture within those constituencies. It is worth noting that the same tool, such as studies showing the benefits of competition, can often be of use to multiple constituencies.

A. General Public

The support of the general public is important for ensuring that competition policy will continue to be respected as a policy priority. Even in countries with market economies, the

[4] *See* G. Becker, *Crime and punishment: an economic approach*, 76(2) J. POL. ECON.169-217 (1968), J. Connor, *Effectiveness of antitrust sanctions on modern international cartels*, 6 J. IND. COMPETITION & TRADE, 195-223 (2006), S. Ennis & S. Kim, *Criteria for setting fines for competition law infringements*, LACF Background Paper, OECD (2013).

general public may be skeptical of the value of competition law. For example, a survey in the United Kingdom found that about 4 in 10 people did not believe price-fixing is a serious offense.[5]

Tools to enhance competition culture with the general public can include:

- childhood and unconventional education tools;[6]
- information campaigns to help consumers identify better deals and lower priced stores;[7]
- the regular presence of the competition authority in the media with positive portrayals and reasonable quotes;
- newsletters by competition authorities that explain cases;[8] and
- repeated emphasis of the benefits of competition resulting from careful, rigorous and unbiased studies.[9]

One aspect of holding a positive view to market competition is believing that private ownership and management of assets is beneficial. Enhancing the positive societal value placed on private ownership can be an important precursor of competition culture for the general public. One tool that increases support for market actions can be privatizations in which shares are sold directly to the public, thus raising funds for the public purse while ensuring a broad base of interested shareholders.[10]

For example, in the United Kingdom, utility privatizations under Margaret Thatcher, such as the British Telecom, Gas, and many other privatizations generally had a trading price of shares on first day of trading that was above the purchase price, so many purchasers had positive financial benefits from their first market investment. Support was built for these privatizations by ensuring that all citizens interested in purchasing shares could do so, while limiting the stake of institutional investors.[11] Again under Margaret Thatcher, the sale of state-owned council housing

[5] *See* Stephan, *supra* note 2 at 123-145.

[6] Jamaica's competition authority produced a children's book for distribution in schools with stories illustrating the benefits of competition for ordinary families and children. Singapore's competition authority produced a cartoon book ("manga") illustrating the harms that come from anticompetitive activity.

[7] In Mauritius, the government introduced a price observatory to help consumers identify those stores that offered the best prices for many products. In the Netherlands, a private individual developed an application to help mobile telephone consumers identify the best calling plans and mobile phone operators, given their calling patterns. In Australia, the government introduced daily reporting of automotive fuel prices by petrol stations, which was communicated to consumers via the internet.

[88] The Indian competition authority produces a regular bulletin about its work that is presented in a way that is attractive to the general public and which explains cases and other activities of the competition authority.

[9] Such studies would often be carried out by academics or think tanks; for example, S. Davies, H. Coles, M. Olczak, C. Pike, & C. Wilson, *The Benefits from Competition: Some illustrative UK cases*, DTI Economics Paper 9 (2004).

[10] While privatizations of government-owned assets or companies are frequently controversial, one way to make them less controversial is through extensive distribution of shares to the public, even if for a price.

[11] In 1979, when Margaret Thatcher took office as Prime Minister, 3 million Britons owned stock shares while at the end of the 1980s, more than 12 million owned stock shares.

to its current tenants helped to instill a culture favoring private ownership of assets, giving groups that were previously unable to purchase homes an opportunity to purchase their home.[12]

B. Government Officials

Government officials often have a profound effect on the competitive environment via the regulations they promulgate and the decisions they take that impact market operation. Regulation at times has profound and effects on competition—effects that can be beneficial or harmful. Assessing competitive effects of regulations and revising those that unduly restrict competition is an important activity that can lie in the domain of government officials. Governments can develop their own materials for such reviews, potentially basing them on other work including the Competition Assessment Toolkit of the OECD backed up by the 2009 Recommendation of the Council on Competition Assessment. Such material can be used by a center-of-government regulatory impact assessor, a ministry, or a competition agency.

The results of using such a Toolkit can be important for bringing government officials to consider competitive effects while developing their policies. Competition assessment of regulations has been used in a number of countries, including Australia, the European Commission, Greece, Mexico, Romania, Spain, the United Kingdom, and many others. To illustrate, when the European Commission establishes new regulations, these must undergo a comprehensive process of regulatory impact analysis. This process includes a review of competitive effects. When there are competitive effects from a proposed regulation, DG Competition may express its views on the regulation and the final analysis will consider these views. In this example, competition culture is developed through embedding competition within administrative processes of review for all government regulations.

To ensure officials developing policy can consider competition appropriately, useful tools—in addition to embedding within administrative processes—include enhancing technical capacities and establishing clearly approved communication channels. For example, to enhance capacities, training can be provided to those officials with a role in producing regulations. The training can be organized by experts in competition, e.g. from an expert ministry or competition authority.

To establish a communications channel, a useful technique is to establish points of contact between competition authority and ministries that issue regulations affecting competition. The contacts could involve regular meetings or communications between officials from different bodies, enshrined within memorandum of understanding agreements ("MOUs"). Many competition authorities, such as the Irish competition authority, have written MOUs with national regulatory bodies. Such contacts can exist not only between national government bodies but also between a competition authority and state, regional, or local level government bodies.

A subset of government officials that is particularly important to reach is those involved in public procurement. Public procurement at times is marred by bid-rigging that typically has the effect of raising prices paid by government. Ensuring that bid-rigging does not occur helps to

[12] When Council housing was sold via the Right to Buy scheme enabled by the Housing Act 1980, it was offered to current tenants at discounts of 33 to 50 percent below the official valuation, with about 2 million Council homes having been sold to tenants since 1980.

ensure an efficient use of funds by government. Appropriate public procurement policies can (i) avoid pre-selection of the winner through contractual conditions, (ii) prevent advance cooperation between bidders, (iii) ensure that penalties from malfeasance are clear (e.g., certificate of independent bid determination), and (iv) ensure that the operational details of cooperation are more complicated (e.g., uneven bid size, a ban on sub-contracting.)

Tools to reach the community of officials involved in procurement and increase their focus on competition include:

- utilizing the *OECD Guidelines for Fighting Bid Rigging in Public Procurement*, supported by the 2012 Recommendation of the Council on Fighting Bid Rigging in Public Procurement;
- teaching competition workshops for officials, such as those that occurred in Chile and Brazil;
- embedding competition training in standard training programs for public procurement officials (Brazil, Canada, Mauritius, South Africa, among others);
- engaging in regular high-level discussions;
- requiring bidders to submit certificates of independent bid determination;
- establishing a MOU that allows sharing of information; and
- establishing contact points at an operational level between procurement bodies and the competition authority.

C. Politicians and Legislators

Politicians have a critical role to play with respect to establishing competition law and determining budget levels for the competition authority. While at times in many countries competition law has been a major national political issue,[13] more generally competition policy has been a background technical issue that does not enter the daily political arena.[14]

Three tools for gaining political support are especially useful. The first is studies that show the benefits of competition. In Mexico, an academic performed a particularly interesting study showing that the poorest decile of the population is disproportionately disadvantaged by limited competitive conditions, spending 41 percent of their household budget compared to 37

[13] One example includes the United States' 1912 election campaign, in which antitrust enforcement was a major topic of the three main candidates (*see* W. Kolasky, *The election of 1912: a pivotal moment in antitrust history*, 25(3) ANTITRUST (2011).

[14] There are exceptions to this in modern times. For example, in Mauritius, competition law fell within a broad political platform based on "democratising the economy."

percent for the top decile.[15] The ICN Benefits Project identifies further techniques and information for explaining the benefits of competition.[16]

A second tool is through occasional private briefings to key politicians about the work of the competition authority, without discussing cases under current evaluation. A final tool is through international policy comparisons that provide a motivation to politicians to keep up with other countries.[17]

D. Journalists and Media

Journalists influence general and specialist opinions about many aspects of business, and also influence business people who read their stories. Competition law cases can constitute regular sources of news, so media may assign particular journalists to cover competition law. Competition authority reputations can benefit from positive articles and suffer serious damage from the publication of articles that are damaging to the authority. At the same time, competition authorities can enhance their reputation and ability to perform their job when journalists write positive stories about the work of competition authorities.

Journalists generally have very specific needs, including short timelines, a desire for exclusive stories, and a need for high-level quotes and access. Competition authorities can help journalists to do their job better. Three specific tools that competition authorities can use with journalists include (i) issuing press releases that contain neutral phrasing and are thus appropriate as a source of text for the journalists; (ii) holding press conferences; and (iii) creating a cadre of journalists who are educated about competition law, and consider it to be one of their specialty areas. Further media tools can include competition authority officials writing regular columns and participating in radio and television programs, as in Zambia. The heads of competition authorities can also hold occasional briefings or lunches with reporters to help to ensure more detailed understanding by journalists of competition law.

E. Academic Centers

Academic centers focused on competition can (i) produce studies of domestic policy conditions and consumer impacts of competition, (ii) provide education, and (iii) train researchers. A tool for promoting such centers is the provision of government financial support.

For example, in The Netherlands, the Ministry of Economy partially financed the Amsterdam Centre for Law and Economics, which was created as a result of a competition between universities to receive a grant from the Ministry in 2003. This institution, which brought together law and economics faculties, is still providing workshops, serving as a center for

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[15] *See* C. Urzua, *Distributive and regional effects of monopoly power*, 22(2) ECONOMIA MEXICANA NUEVA EPOCA, 279-295 (2013).

[16] According to the Advocacy Working Group Workplan for 2012-2013, "The Benefits Project seeks to provide ICN members with knowledge, strategies and arguments for explain the benefits of competition to support their competition advocacy efforts with government and non-government stakeholders."

[17] Particularly when competition laws are being re-written, legislators or ministers and their staff may be interested to know international best practices, which can be provided by many routes, including through international organization such as the OECD and UNCTAD.

competition-related research, and its faculty promote their ideas in national debates of relevance to competition.

In the United Kingdom, the Centre for Competition Policy at the University of East Anglia, partially funded by a grant from the U.K.'s Economic and Social Research Council, provides extensive research and advice on competition that is grounded in public policy questions and needs.

F. Law Schools

One of the greatest challenges for enforcing competition law in countries with a new law is the lack of legal professionals with a specialization in competition law. Law schools can play an important role in helping to train the legal professionals of the future, ensuring a long-run supply of legal professionals with the appropriate expertise.

The offering of at least one competition law course can yield substantial benefits over the long run. Given the absence of domestic experience with competition law, such a course may potentially focus on international experiences with competition law. Of course, offering such courses requires that law schools have professors with the expertise to teach such a course. One technique for achieving this is to send a law professor overseas for a six-month or one-year fellowship during which they would take competition law courses and prepare research in that area while interacting with established legal experts in this area of the law.

G. Competition Bar

National lawyer associations can spread experience and training in competition law to practicing professionals. This can occur, for example, by organizing workshops or seminars, ideally as part of on-going professional training requirements. The American Bar Association has been a leader in developing expert materials and running topic-specific and general meetings for its members, due to the work of the Antitrust Section.

While the Antitrust Section may do excellent work, many countries do not have the core size of practitioners needed to make such a specialist bar successful. Nonetheless, the general lawyer association can still play a useful role in promulgating awareness of competition law as a practice area.

A particular challenge in small countries may be to convince successful practicing lawyers to add a new specialty of competition law, or to convince new lawyers to specialize in an area where they cannot practice full time and do not know whether they would have any clients. One tool to overcome a reluctance by practicing lawyers to invest in competition law is for the lawyer association to organize workshops that provide continuing legal education credits, a particularly strong incentive in those countries that have a requirement for such on-going professional training.

H. Judiciary

The judiciary clearly plays a key role in determining competition law enforcement outcomes. Unlike lawyers dealing with competition law cases, judges are unlikely to be experts in competition law, unless specialist courts have been created. The purpose of activating competition culture among judges is not to make judges decide cases in favor of competition

authorities, but rather for them to engage with the concepts that would be used in competition law cases in advance of dealing with their own first competition law case.

A useful tool for engaging with judges is workshops, often under the aegis of a judicial network. Law schools, law professors, and judicial organizations are in a strong position to advocate or propose relevant workshops. For example, Mauritius started a training center for judges and barristers known as the Institute for Judicial and Legal Studies, headed by a judge for the Supreme Court. The Institute sponsors workshops for judges as well as for barristers. Also, a number of workshops on European competition law for national judges have been held at the OECD-GVH Regional Centre for Competition.

I. Business

The crux of market competition is to ensure that businesses effectively compete with each other. The transformation that may be necessary as a business community adapts to a new legal framework can be difficult and slow. Sudden changes in policy such as the application of competition law need time to seep through to business. However, competition authorities can help the process along.

For example, in Australia, when the competition authority began considering actions in the health sector, brochures explaining how competition law could apply to health practitioners were prepared and distributed. Speeches were given along with workshops for the affected medical practitioners and managers. These actions laid down a clear set of signals to indicate which business behaviors were appropriate, and which were not. Placing these signals in advance ensured that business would have time to adjust to a new legal environment, and adjust their dealings accordingly, prior to any competition enforcement.

J. Business Associations

Business associations such as national Chambers of Commerce and specific trade associations can be important for spreading information about competition law to businesses in a form that is understood and respected by business people. One example of recent work that can be valuable to companies is the compliance toolkit prepared by the International Chamber of Commerce Commission on Competition.[18] The design of this toolkit benefited from the experience of large companies, but it is designed to provide help and guidance on competition law compliance to medium-sized companies as well.

Business associations can serve as valuable conduits for educating the business community and answering questions of business operators in a cost-effective manner. Another example of recent work is the book on competition law in Mauritius published by the Mauritius Chamber of Commerce and Industry, providing competition law guidance to business operators in ordinary language, with practical, illustrative examples from countries with a longer experience of competition law enforcement.

[18] The ICC Antitrust Compliance Toolkit "seeks to complement materials produced by antitrust agencies and other sources of guidance, by focusing on practical steps companies can take internally to embed a successful compliance culture." *See* http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2013/ICC-Antitrust-Compliance-Toolkit/.

K. Consumer Associations

Consumer associations may represent a diverse set of interests and, at times, receive their funding from governments, making the interest group they represent particularly disembodied. Consumer associations typically claim to represent the interests of consumers as purchasers. Some associations validate these claims by preparing journals with buying advice (to name just a few—*Which?* (United Kingdom), *Que Choisir* (France), *Consumer Reports* (United States)) as well as by delivering reports and testimony to government or appearing in the media.

Consumer associations can be powerful promoters of a pro-competition agenda, particularly by shining the light on anticompetitive behaviors in a vocal, attention-getting way that would be unseemly and inappropriate for a competition authority. Consumer associations can also serve as an excellent source of complaints and leads. Particularly when complainants are reluctant to come directly to the competition authority, consumer associations can play a particularly important role as an intermediary. One tool for activating consumer associations is illustrated by the U.K. process whereby a consumer association can call for an investigation via a legislatively defined “super complaint.”[19]

III. KEYS TO SUCCESS

Competition agencies are by no means the only motors for enhancing competition culture within particular constituencies, but they can be one of the most important. Another key motor can be the ministry responsible for competition policy. A third motor is people from within the constituencies themselves who are interested in competition policy. Whatever the motor, communication and quantitative estimates can play a critical role when competition agencies seek to reach key constituencies to promote stronger competition culture.

Creativity is a valuable element of communication. The Competition Commission of Mauritius, for example, held a “Competition Week” in 2011 in which three events were held, each one targeting a different constituency and with different content. One event was for university students to raise law students’ and economics students’ awareness of competition law and policy; one was primarily for business people; and the last one was for professionals, notably those with expertise in legal and economic analysis. While the three events were all targeted at relatively narrow audiences, news about the events, including from a press conference held the week before, ensured that the competition authority was in the news repeatedly over a two-week period.[20] The competition week raised awareness of the value of competition among the general public.

Quantitative estimates can be particularly important for showing politicians, government officials, and the general public that competition matters and for explaining the mechanisms that ensure it matters. The Competition Commission of Mauritius estimated that, after entry of new

[19] The super-complaint power was first used by the U.K.’s Which? to call for an investigation of private dentistry in 2001.

[20] One rule of thumb from the advertising business is that in order to have lasting impact on an individual, an advertising campaign should reach that individual multiple times within a month. One impact of the Competition Week was that many individuals did have three or more impressions of the competition authority over a period of two weeks, either from watching the evening television news, reading the daily newspaper, or listening to the radio news.

brands following a Competition Commission decision that eased entry of new block-processed cheese brands, prices for incumbents fell by 4.5 percent. Further, given that new brands adopted lower price strategies, the lowest price available fell by 14 percent, yielding projected consumer benefits of U.S. $4.6 million to $21 million.[21]

IV. CONCLUSION

In order to create a competition culture, many different constituencies need to understand those aspects of competition law and policy most appropriate for them. It is unrealistic to expect that all members of society would be in favor of competition. For example, officials from self-interested companies that benefit from regulations that restrict entry by other companies will likely advocate against competition, at least in their domain. Professional groups may likewise seek to create professional rules that enhance scarcity of professional services and enhance professional incomes, at the expense of their clients. Companies involved with cartels could be expected to advocate against effective cartel laws and against effective enforcement.

The fundamental challenge of the political economy of reform is often stated as the fact that benefits from reform are diffuse while costs of reform are concentrated. Achieving a stronger competition culture can help to give more strength to the diffuse interests by creating recognition of the bias of certain lobbies and the harm they may cause.

The level of competition awareness among the general public, media, and politicians may be important for winning overall support for competition policy and competition law. In any given constituency, universal awareness and understanding of how competition works and how market power can be abused are not essential. Pragmatically, there are people in each constituency who will be more important than others. For example, among the judiciary, judges who decide on competition law case outcomes will be more important to reach than judges who might never decide on outcomes, such as judges who are specialized in family law. Among journalists, those reporting on business affairs can be important, while those reporting exclusively on politics or sports will not be important.

This paper has sought to provide a framework for developing strategies that promote competition culture. In order to enhance the monitoring of effectiveness of such strategies, it would be valuable to measure different facets of competition culture to measure success in achieving a competition culture among the relevant people in each constituency. Even countries with long histories of market economy operation may come out with weaknesses in some respects. Identifying weaknesses and strengths in competition culture can then be a first step to developing a strategy to achieve and enhance competition culture.

[21] *See, Evaluation of CCM Case: IBL Consumer Goods Sales Contracts with Retail Stores*, CCM Report, (November 18, 2011).

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Judicial Evaluations of Minimum Resale Price Maintenance Behavior

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Judicial Evaluations of Minimum Resale Price Maintenance Behavior

Ding Wenlian[1]

I. INTRODUCTION

On the judicial cognizance of vertical agreements stipulated in Article 14 of China's Anti-Monopoly Law ("AML"), scholars mainly have taken one of two views. One view adopts the dominant principle currently applied in U.S. judicial practice, the "rule of reason" approach, in which the burden of proof lies on the plaintiff to prove both the existence of vertical agreements and that the agreement has the effect of excluding or restricting competition. The second view adopts a dominant principle similar to what is currently used in EU judicial practice, the so-called "rebuttable presumption" approach, which presumes that vertical agreement is illegal. Under this view, the defendant needs to cite Article 15 of the AML and present legal evidence to prove its behavior legitimate.[2]

These views are applicable to antitrust enforcement and judicial practice. For the analysis of the nature of minimum resale-price-maintenance ("RPM") agreements and such acts, there are many differences in legal evaluation principles, analyses, evaluation factors, and the distribution of burden of proof. Regarding these issues, we would propose some preliminary opinions that are combined with the judgment of the second instance of the *Johnson & Johnson* case that was decided by the Shanghai Higher People's Court in August, 2013.[3]

II. LEGAL EVALUATION PRINCIPLES OF MINIMUM RPM BEHAVIOR

A. Three principles in European and American Practice

Antitrust regulations originated in the United States when the world's first antitrust law, the "Sherman Antitrust Act," was passed in 1890. Article I of the "Sherman Act" states that "[e]very contract, in trust form or other forms of alliance, conspiracy, used to restrict interstate trade or commerce with foreign nations, is illegal." This provision is considered to be the legal basis for antitrust intervention of minimum resale price maintenance behavior. In 1911, in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, the U.S. Supreme Court ruled, for the first time, that resale price maintenance was in violation of Article I of the "Sherman Act," and explicitly stipulated that the behavior of resale price maintenance was applicable to the "*per se* illegal" principle. As such, manufacturers' control of dealers' pricing behavior is considered illegal.

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[1] Deputy Chief Judge, Senior Judge of Intellectual Property Tribunal, Shanghai Higher People's Court. The author gratefully acknowledges helpful comments from Vanessa Yanhua Zhang.

[2] Huang Yong, *Enforcement Analysis and Path Discussion of Resale-Price-Maintaining Agreement*, 12 PRICE THEORY AND PRACTICE (2012).

[3] Vertical Monopoly Agreement Disputes among Beijing Ruibang Yonghe Technology Trading Co., Ltd. v. Johnson & Johnson (Shanghai) Medical Equipment Co., Ltd., Johnson & Johnson (China) Medical Ltd., Judgment of Second Instance No. [2012] Hu Gao Min San (Zhi) Zhong Zi No. 63, August 1, 2013.

For nearly 100 years since then, the protocol actions of fixed resale prices and minimum resale price maintenance have always applied to the " *per se* illegal" principle, though the United States Courts posed certain restrictions on the scope of illegal resale pricing activities during that time (e.g., manufacturers' unilateral acts, pricing behavior in agency relationships, and maximum resale price maintenance are excluded). On June 28, 2007, in *Leegin,*[4] the U.S. Supreme Court overthrew *Dr. Miles,* explicitly stipulating that RPM no longer applies to the "*per se* illegal" principle, and took the " rule of reason" principle as an impartial and efficient way to prohibit RPM with anticompetitive effects while protecting those RPMs that have the effect of promoting competition."[5]

The U.S. Supreme Court has given certain legislative powers to states in regards to antitrust law and, after the *Leegin* case, the judicial standpoint of many states regarding RPM diverged. Some states adopted the "rule of reason" principle in state law to follow the *Leegin* case, while some states clearly defined in their antitrust laws that the RPM behavior applied to the "*per se* illegal" principle.

The U.S. Supreme Court's changes in the legal evaluation principles of minimum resale price maintenance behavior not only affected U.S. antitrust law enforcement and judiciary, they also affected antitrust law enforcement and justice in other countries and regions. For example, the European Union, a major jurisdiction of international antitrust enforcement, has also experienced a process of change in its legal regulation of resale price maintenance. The current applicable legal bases include: Articles 101 and 103 of the "Lisbon Treaty," the 2010 European Commission Regulation on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices (referred to as the "2010 Regulations"),[6] and the 2010 European Commission Guidelines on Vertical Restraints (referred to as the "2010 Guidelines").[7] The latter two documents replaced the old regulations from December 1999 and the old guidelines from May 2000.

According to the 2010 Regulations, in the case of maximum resale price maintenance when resale price recommendation behaviors are in line with certain conditions (i.e., the market shares of the seller and the buyer are lower than 30 percent in their relevant markets), a block exemption can be obtained. But minimum resale price maintenance and fixed resale price behaviors are core provisions to restrict competition, regardless of market share of the implementation enterprises, so no block exemption can be obtained. This practice is in line with the 1999 Regulations.

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[4] Leegin Creative Leather Products, INC.v.PSKS, INC., 551.US. (2007).

[5] Between "*per se* illegal" and "rule of reason," a "*per se* legal" legislative tendency also exists. In 1937, the U.S. Congress passed the Miller-Tydings Resale-Price-Maintenance Act, which stipulated that if the state law allows the minimum resale price to be legal, then the minimum resale prices will not be subject to Article 1 of the Sherman Act. Subsequently, in 1952, the McGuire Act passed by Congress expanded the scope of RPM, stating that as long as one distributor signs the RPM contract with the manufacturer the manufacturer can apply RPM to all distributors. However, these two Acts were widely opposed, and were abolished in 1975.

[6] Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. Official Journal L 102, 23.4.2010, p. 1-7.

[7] Commission Notice- Guidelines on Vertical Restraints, Official Journal C 130, 19.05.2010, p.1.

However, possibly due to the influence of the 2007 *Leegin* case in the United States, the 2010 Guidelines are different from the 2000 Guidelines. For minimum resale price maintenance and fixed resale price behavior, individual case exemptions are granted based on the following circumstances: (i) when designed to stimulate the dealers to pay for the extra effort needed to sell products during a new product promotion period, especially when the same results cannot be achieved by other means; (ii) for franchises or similar forms of united sales organizations, a short-term (2-6 weeks for the vast majority of cases) low-price promotional activity is required, with such promotions being equally beneficial for consumers; and (iii) the parties can prove that resale price maintenance is a necessary measure to avoid pre-sale service freeriding.[8]

Elsewhere, some countries such as Australia and Japan are considered to apply the "*per se* illegal" principle. Other countries, however, such as South Korea, are considered to apply the "rule of reason" principle.[9]

In short, in the world's major antitrust jurisdictions, there are actually three legal evaluation principles against resale price maintenance: (1) "*per se* illegal" principle still used by a small number of states in the United States; (2) "rule of reason" principle adopted by the United States Supreme Court and most U.S. states; and (3) the so-called "principle of prohibition + exceptional exemption" principle represented by the European Union. Each of these three principles has their own merits. Whether they are applicable to China is subject to specific analysis.

B. Analysis and Evaluation of the Three Principles

1. The *Per Se* Illegal Principle

First, the "*per se* illegal" principle lacks empirical economic basis, and is in discord with real-world experience. Evaluating an act by the "*per se* illegal" principle means that this behavior is absolutely prohibited, and the legal basis should be that such behavior is: (i) in serious conflict with accepted ethical values, (ii) causes serious damage to private interests, and/or (iii) causes a certain degree of damage to the public interests.

In China, the Anti-Unfair Competition Law was adopted in 1993 to place curbs on certain kinds of anticompetitive excesses, such as deceptive advertising, coercive sales, appropriation of business secrets, and bribery. However, the leadership decided that more comprehensive anti-monopoly legislation was needed and in 2007, the country enacted the Anti-Monopoly Law. The Anti-Monopoly Law is different from the Anti-Unfair Competition Law, although both are designed to promote competition in the market. The evaluation basis of Anti-Unfair Competition Law to market behavior is mainly based on whether the behavior is contrary

[8] Guidelines on Vertical Restraints (2010 / c 103/01). In the Guidelines, preventing free-rides in pre-sale service means that, in some cases, the additional profits arising from resale price maintenance will enable retailers to offer additional pre-service especially for expensive or complex goods. Customers take advantage of this kind of pre-sale service to make purchasing choices, but purchase goods from those retailers who do not offer this pre-sale service, but just sell goods at a lower price. Then the number of retailers who provide pre-sale service will decrease, and even pre-sale service could be completely cancelled by retailers. Resale price maintenance may reduce this "free-riding" phenomenon.

[9] XU Xinyu, *Comparative Analysis of Vertical Price-Fixing Agreements Legal Regulation*, PRICE SUPERVISION AND INSPECTION IN CHINA, VOL. 7 (2012).

to accepted business ethics, while the evaluation basis of Anti-Monopoly Law to market behavior is based primarily on whether the behavior eliminates or restricts competition in the market. Therefore, the Anti-Monopoly Law should not use *a priori* moral law, but rather experienced-based evaluation as its legal basis.

As for whether a market behavior shall be absolutely prohibited, according to the Anti-Monopoly Law, a market behavior shall not be prohibited out of *a priori* moral judgment, but should be based on empirical analysis of the actual competitive effects of the market behavior. So, to take the absolute prohibition stance of the "*per se* illegal" principle on the use of minimum resale price maintenance, there should be empirical arguments to show that minimum resale price maintenance behavior is a behavior imposing serious harm to market efficiency (i.e., the behavior causes pure harm to competition in the market, or has the effect of promoting competition but its effect is far less than the competition harm effect).

However, we still have not seen such empirical economic analysis, and the existing empirical analysis neither supports the conclusion that minimum resale price maintenance does harm to competition, nor does it support the conclusion that minimum resale price maintenance promotes competition. However, empirical studies have shown that resale price maintenance can lead to price increases. But price increases may be caused by increased consumption or quality improvements of product and service, so it is difficult to conclude that minimum resale price maintenance harms market competition simply based on the observation of price increases.[10] Further, real-world experience and economic analysis tell us that, at least in some cases, minimum resale price maintenance does promote competition. For example, for those products that need effective pre-sale services, minimum resale price maintenance is efficient for promoting pre-sale services.

Due to this common understanding, EU legislation has experienced adjustments, as mentioned above, allowing minimum resale price maintenance in certain cases that clearly have the effect of promoting competition. Today, the continued use of the "*per se* illegal" principle for minimum resale prices maintenance not only lacks economic basis, but also goes against real-world experience.

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[10] Nathaniel J. Harris, *Leegin's Effect on Prices, An Empirical Analysis*, J. L. ECON. POL'Y (Winter, 2013). This paper used a "Difference in Differences Model" to compare CPI (Consumer Price Index) changes for the same period in U.S. markets with resale price maintenance and without resale price maintenance. The author also compared CPI changes in the areas with absolute prohibition of resale price maintenance (called "*per se* illegal" principle areas) and the areas without absolute prohibition of resale price maintenance (called "rule of reason" principle areas). The author found that CPIs in areas with minimum resale price maintenance and absolute prohibition of minimum resale price maintenance are higher than those in the areas without minimum resale price maintenance and absolute prohibition of minimum resale price maintenance. After considering population composition, changes in income, and multiple other factors, he determined that implementing minimum resale price maintenance and the legal-attitude toward minimum resale price maintenance behavior are highly correlated with CPI, supporting the conclusion that minimum resale price maintenance tends to result in market prices increase. This article is rigorous and reasonable on sample selection and comparison methods, and its conclusions are credible. Nevertheless, this article still believes that there is also consumption increase and other factors that promote competitive effects in the presence of price increase. We shall not deny the principles established in the *Leegin* simply because the resale price maintenance leads to price increase.

2. The Principle of Prohibition + Exception Immunity Principle

Second, the "principle of prohibition + exception immunity" principle also lacks an empirical economics basis. Just like the "*per se* illegal" principle, the application of "principle of prohibition + exception immunity" principle to minimum resale price maintenance action should be based on the following empirical economic basis: in the market, the vast majority—or at least the majority—of minimum resale price maintenance behaviors have the effect of restricting competition. As mentioned earlier, at present there is still no empirical evidence to support such a conclusion. In this case, if we prohibit certain behavior that has unknown competitive effects, competition may either be enhanced due to correct judgment, or be harmed due to misjudgment.

In fact, competition is always dynamic. In the short-term, small-scale restrictions of competition do not often last long, and they will always be overcome by the dynamic development of competition in the market. Any so-called "market failure" will eventually be self-corrected by the market in most cases. Instead, wrongful interventions of the "visible hand" lead to reduced competition in the market and, because the error is institutionalized, it becomes difficult to get corrected by the market itself. Thus, on balance, the loss caused by the wrong judicial intervention will outweigh the benefits brought by the proper administration of justice. And taking the "principle of prohibition + exception immunity" principle for behavior with an unknown effect is a selection of higher risk. Taking the principle of prohibition to minimum resale price maintenance has a higher likelihood to undermine the economy than to improve the economy.

At the same time, we see that China's current market practice of minimum resale price maintenance behavior can be found everywhere, at a time when the Chinese AML practice in its infancy. Applying the "principle of prohibition" to minimum resale price maintenance will lead to a low threshold for minimum resale price maintenance enforcement and litigation, causing a huge impact on the reality of economic life. China, as an emerging market, has a market that is relatively active. New businesses, new products, and new brands come into the market constantly. Since the minimum resale price maintenance is conducive to the promotion of new businesses, new products, and new brands coming into the market, this behavior should not be denied in principle in China.

It should be pointed out that there are views expressing the belief that Articles 13, 14, and 15 of China's Anti-Monopoly Law indicate that the AML applies principles similar to the European Union's "principle of prohibition + exception immunity" to the minimum resale price maintenance behavior. Therefore, judiciary implementation should follow this principle. In this regard, it is necessary to emphasize that during the development of the AML the U.S. *Leegin* case had little influence on the studies of Chinese antitrust legislation. The negative effects of minimum resale price maintenance behavior were more fully understood, and its positive effects were not recognized enough. So even though legislation at that time seems to have taken a relatively stringent stance, today we can still take advantage of the space left in the law as expressed, and explain its position to be more in line with market principles and more in line with market development needs.

3. The Rule of Reason Principle

Third, the "rule of reason" principle has been charged with being too flexible and lacking certainty. Relatively speaking, applying the "rule of reason" principle to minimum resale price maintenance behavior is a choice more in line with the real market situation and has greater accuracy of judicial adjudication. However, if we only apply the abstract "rule of reason" principle and make an exhaustive review of every point in each specific case, the defendant may form a "reasonable cause" defense, making such proceedings too flexible, resulting in a plethora of reviews and considerations in an individual case, and at too great a judicial cost.

A better situation would be if there were relatively clear guidelines on the direction and focus of antitrust analysis of minimum resale price maintenance behavior that are convenient for judges to follow and make it easy to render accurate and efficient analyses and judgments. They would also allow corporate entities to have clearly defined expectations of legality of minimum resale price maintenance behavior, and there would be a relatively clear guide for society.

C. "Real Effects Principle" in the Johnson & Johnson Case

The final judgment in the second trial of the *Johnson & Johnson* case referred to above upheld the view that minimum resale price maintenance agreement is not *per se* illegal, and it explicitly excluded the applicability of the "*per se* illegal" principle. According to the definition of a "monopoly agreement" in Article 13I of the AML, "the effect of excluding and restricting competition" is the constituent element of monopoly agreements. And the Article further defines minimum resale price maintenance behavior as a monopoly agreement only if the behavior produces effects of eliminating or restricting competition that are difficult to avoid or difficult to be offset by its effects of promoting competition. Therefore the Court advocated a practice which is different from the E.U.'s "principle of prohibition + exception exemption" approach, and the U.S. approach of "rule of reason" principle. For the time being, we can name it the "real effect measure" evaluation principle.

As described below, the "real effect measure" principle embodied in the judgment of the second instance of the *Johnson & Johnson* case has intentionally filtered factors not big or important enough to have impact on competition in the market, but just focuses on those factors that have substantial impact on competition in the market that can improve judicial accuracy and also improve litigation efficiency.

III. EVALUATION ELEMENTS OF MINIMUM RESALE PRICE MAINTENANCE BEHAVIOR

The second trial of the *Johnson & Johnson* case upheld that implementing antitrust intervention on a resale price maintenance action must be based on the premise that the resale price maintenance behavior obviously produced the effect of eliminating or restricting competition which is difficult to overcome or to offset. The four aspects most important to consider when evaluating whether minimum resale price maintenance behavior is legal or not are:

A. whether competition in the relevant market is insufficient,

B. whether the defendant's market position is strong,

C. the defendant's motivation in establishing resale price maintenance, and

D. the practical effects from the resale price maintenance arrangement.

A. Relevant Market: Whether Competition is insufficient

On the one hand, in a fully competitive market—such as the clothing market—due to the large number of firms competing with each other, it is difficult to form a tacit understanding on pricing between different brand manufacturers, and even harder to form an explicit or tacit price agreement. Therefore, it is difficult to achieve a so-called vertical restraint agreement on manufacturer cartels or dealer cartels in a fully competitive market. On the other hand, since there is sufficient competition of products in the relevant market, consumers have sufficient alternatives. If a firm agrees to a fixed price or minimum resale price maintenance arrangement for some reason, although the maintenance will reduce some purchasing behavior by consumers who would buy the product below the limit price, consumers can still choose other brands of products at lower prices or of better quality at the same price. Consumer welfare is not damaged, nor is the economic efficiency impaired.

But in an insufficiently competitive market, due to lack of adequate alternatives, consumers rely on a particular brand or a few brands. If price maintenance is implemented on certain brands of products, not only will price competition be absent within the brand, but there will also form a tacit understanding between the different brands on pricing. Or, if no understanding is formed, due to the lack of price competition market prices would rise or remain at a high level, resulting in damages to both consumers and social welfare as a whole.

Thus, insufficient competition in the relevant market is the prerequisite to judge that a minimum resale price maintenance agreement constitutes a monopoly agreement. Only when the lack of full competition in the relevant market situation is affirmed do we need to further determine the competitive effects of the alleged monopoly agreement. As for judgment of sufficient competition in the relevant market, it should be determined in context with the specific circumstances of the case. We should not only consider the concentration ratio of the market, but also consider alternative products involved, the difficulty for potential competitors to enter the relevant market, the competitiveness of downstream markets, and many other factors that affect the degree of competition in the relevant market.

B. Implementation Enterprise: Does the Defendant Have Strong Market Power?

First, it should be clear that the "monopoly agreements" stipulated in Articles 13 and 14 of the AML and the "abuse of dominant market position" stipulated in Article 17 of the AML have different restrictions on market position of the firms. The latter requires companies to have a dominant market position in order to identify illegal behavior, but the former does not have this requirement. The reason for this is that the latter concerns the behavior of an individual firm, but the former concerns behavior jointly implemented by several firms. Although the two behaviors can only be deemed as illegal when they eliminate and/or limit competition as stipulated by the AML, the requirement of determining market power of these two types of companies is different. Therefore, judging minimum resale price maintenance behavior to be illegal does not take into consideration whether the company has a dominant market position.

However, it should be recognized that the market position of a company is the basis for whether a company's pricing behavior can affect market competition. If companies that

implement minimum resale price maintenance enjoy strong market positions in the relevant market and therefore can have an impact on competition in the market, this ability should be used as a necessary condition to judge whether the minimum resale price maintenance agreement constitutes a monopoly agreement. A company lacking a strong market position in the relevant market usually can only adapt to market competition, and has little ability to affect competition, let alone lead the competition. If the company does not have an advantage in any market aspects—including market share, supply of raw materials, key technologies, sales channels, or brand image—then the company does not have the power to affect market competition, and its implementation of minimum resale price maintenance would not affect competition in the market. Or, if it affected competition within a short time and a small range, it would soon be corrected by more efficient market competition. In short, the effect of competition that needs to be eliminated or restricted by the AML would not appear.

Therefore, whether the company implementing minimum resale price maintenance has a strong market position should be considered as the foundation to judge whether the conduct of minimum resale price maintenance might have the effect of excluding or restricting competition. That leaves the question: When should a company be considered as having a "strong market position," so that its behavior of minimum resale price maintenance may eliminate or restrict competition?

We argue that a company's market position lies in its pricing power. When other things are equal, if a company has a strong pricing power, it dominates in pricing negotiations with buyers, and it can calmly and freely set the prices rather than being a price taker. Then the pricing of other companies in the relevant market may be affected by the pricing of that company, and that company should be considered to have a strong impact on market competition. In another situation, when other things are equal, if the company implements minimum resale price maintenance, and its market share does not fall but rises, this can also indicate that the company has a strong market position in the relevant market (the reverse is not true—that is, one cannot conclude that a company does not have a strong market position if its market share falls after it implements minimum resale price maintenance.).

It should be pointed out that, among the above four elements, insufficient competition in the relevant market and whether the implementing company has a strong market position are necessary conditions to judge whether minimum resale price maintenance constitutes a monopoly agreement. The decision actually requires the market structure to be a screening condition to judge whether the minimum resale price maintenance constitutes a monopoly agreement. The screening scheme not only draws on the experience of other jurisdictions,[11] but

[11] In the *Leegin* case, when the U.S. Supreme Court judges whether an agreement of price-fixing and RPM is legitimate or not, three factors shall be considered: (1) whether the RPM agreement is driven by the upstream producers or downstream retailers; (2) whether producers or retailers implementing the RPM agreement have market power; and (3) whether the RPM agreement is related to a cartel or potential cartel plan. *Leegin Creative Leather Products Inc. V. PSKS Inc., 551 US877 (2007), p.897-898.* American scholars Phillip E. Areeda and Herbert Hovenkamp proposed that in cases involving resale price maintenance, the following eight market factors can be studied for rule-of-reason analysis: producers concentration, distributors concentration, RPM market coverage, distributors motivation, brand power, distributors dominance, optional RPM, and whether the products are homogeneous. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, 2ND ED., 328-329 (2004). Quoted from

also takes into account the current status of China's market's economic development, including its immature market development and the prevalence of minimum resale price maintenance in various industries. Taking the market structure as a screening condition helps to stop the conducts that cause actual damage to competition in the market as a whole.[12]

C. Motivation: Whether Inefficient Methods are Used to Cope With Price Competition

Although motivation does not correspond exactly to behavioral effects and motivation is difficult to observe in complicated market activities, if a company with a strong market position implements minimum resale price maintenance to limit competition in the market, due to its dominance in all aspects—including finance, technology, and information—its capacity to control the upstream and downstream markets is often strong and the possibility that its conduct of minimum resale price maintenance will lead to the effect of restricting competition will be greatly enhanced. Therefore, although the motivation to restrict competition cannot be deemed a necessary condition to judge that the minimum resale price maintenance has the effect of eliminating or restricting competition and that RPM constitutes a monopoly agreement, it still can be considered an important reference factor to determine the nature of minimum resale price maintenance behavior.

In a fully competitive market, there are usually two ways for companies to respond to market price competition: one is to reduce prices in order to maintain or expand market share and the other is to not cut the price, but improve the quality of products or services to gain market share. Both methods are conducive to providing better products and services at lower prices in the market. Both are efficient ways to compete.

However, in markets with insufficient competition, companies with dominant market position do not necessarily use these two efficient ways to deal with competition. Fixing resale prices and minimum resale price maintenance may be used to improve service, maintain the brand image, promote new brands, develop new products, etc., which benefit market competition and consumers. But they may also be used to realize price-fixing cartels. Dominant companies may also: (i) use monopoly power to obtain high profits, (ii) use monopoly power to squeeze out competitors, or (iii) use dominant market position to practice price discrimination and other goals that are not conducive to market competition or in consumers' best interests. When evaluating specific cases, specific evidence in the case should be used to analyze and judge the defendant's motivations to take minimum resale price maintenance behavior. For non-efficient ways to cope with price competition, the judiciary should maintain a high degree of vigilance.

Someone may raise the question: If whether the market competition is harmed is the result of completely objective evaluation, why should behavioral motives even be considered a factor in the determination of a monopolistic act? First, since behavioral motivation does not correspond to behavioral effect, this article takes behavioral motivation to harm competition as

SANDRA MARCO COLINO, VERTICAL AGREEMENTS AND COMPETITION LAW-A COMPARATIVE STUDY OF THE EU AND US REGIMES, 85-87 (2010).

[12] LI JIAN & TANG FEI, ILLEGALITY AND LEGAL REGULATIONS OF RESALE PRICE MAINTAINING, CONTEMPORARY LAW. 6TH ED. (2010).

an important factor for auxiliary judgment—not as a necessary condition to determine whether minimum resale price maintenance constitutes a monopoly agreement, nor are these facts that the plaintiff must prove. Second, it should be recognized that whether determined by principles or not, behavioral motivation investigation has always been an important consideration factor in such cases.[13] Therefore, the plaintiff's failure to prove incorrect motivation does not affect the court's identification of monopolistic behavior based on other facts. But if the plaintiff can prove this fact, it will greatly enhance the judge's inner judgment of monopolistic behavior.

D. Actual Effect: Whether the Effect of Eliminating or Restricting Competition is Observed and is Difficult to Offset

Minimum resale price maintenance may produce a variety of negative anticompetitive effects, but it also may produce a variety of positive effects by promoting competition. On one hand, because the market has certain self-correcting capabilities, some anticompetitive effects will soon be corrected by the market; on the other hand, due to the possible existence of both positive and negative effects at the same time, some anticompetitive effects will be offset by some other pro-competitive effects. Therefore, only those negative effects that are difficult to be corrected by the market, or difficult to be offset by other positive effects, should be eliminated by antitrust intervention. Thus, in the analysis, assessment, and evaluation of the competition effect of the minimum resale price maintenance behavior, we pay special attention to positive and negative effects that have substantial impact on market competition.

1. Negative Effects of Limiting Price Competition

First, consider the negative effects of limiting price competition. In the existing economic literature, minimum resale price maintenance is considered to have some of the following negative effects of restricting competition:

1. it limits price competition within the brand, and reduces consumer welfare;
2. it limits resellers' pricing freedom, and cannot identify efficient distributors;
3. it facilitates manufacturer or distributor cartels, and restricts competition between brands;
4. although it may improve distribution services, some consumers do not need these services and would rather enjoy gains brought by lower prices;

[13] In the *Monsanto* case, the U.S. Supreme Court held that the Court of Appeal applied the wrong standard of proof. One should not determine that agreements or joint actions exist between Monsanto and other distributors just because Monsanto canceled plaintiff's sales qualification based on other distributors' complaints. The reason is that for manufacturers, distributors are important source of information, and distributors' complaints about price reducers are generated in a very normal process of transaction. There must be direct or indirect evidence that can reasonably prove that the manufacturer and others intentionally seek to achieve an illegal purpose, so it can be identified that manufacturer and distributors jointly fixed prices. This opinion can be quoted as an evidence standard issue. Looked at from another angle, it can also be considered to determine the manufacturer's maliciousness by evidence. In fact, in cases adopting "rule of reason," the defendant's interpretation and proof of behavioral motivation have always been an important factor in the court's judgment.

5. when lack of price competition and lack of competing pathways exist it may lead dealers to compete in high advertising investments, excess packaging, and other uneconomical activities; and
6. due to the lack of price competition, dealers may use commercial bribery and other illegal means to compete.

Among the results described above, points (4) and (5) involve excessive service, excessive publicity, excessive packaging, and other uneconomical problems that can be corrected by the market itself, and these do not need to be eliminated by antitrust enforcement. As for the unfair competition issues involved in point (6), there might exist a number of assumptions. For example, the dealer does not have other legitimate means to competition, or after the dealer makes a comprehensive assessment of risks caused by the punishment, he still believes the benefits from unfair competition outweigh the costs, etc. This point needs to be examined carefully in specific cases.

Points (1), (2), and (3) have direct or indirect impacts on price competition within brands and between brands. Because the price mechanism is the most competitive market-based mechanism, price restriction has more obvious effects of limiting competition in the market relative to non-price restrictions. So price restrictions should be of great concern in the effects analysis of whether minimum resale price maintenance agreements limit competition.

2. Positive Effects of Limiting Price Competition

Second, consider the positive effects of promoting the quality of products or services, enhancing new products, or enabling new companies to enter the markets. In the existing economic literature, minimum resale price maintenance is considered to likely have some positive effects of promoting competition, including:

1. it prevents free-riding dealers from not providing distribution services (advertising, products, promotions, etc.) but, instead, using price reductions to win customers from those dealers who provide distribution services, thereby contributing to improved dealer distribution services;
2. it helps maintain the business reputations of manufacturers, distributors, and products, leaving people with the impression of quality assurance;
3. it avoids confusing retail prices and provides a basis for consumers to compare prices;
4. it protects small dealers by safeguarding dealers' profits while limiting the market power of large-scale dealers and dealer concentration, and prevents arbitrage between dealers, thus contributing to the construction of the distribution network;
5. when dealers sell multiple brands of products of different competitors, companies adopting minimum resale price maintenance can motivate distributors to sell their products against competitors' discounts and sales;
6. it reduces risks for dealers when the market is uncertain, and guarantees products inventory and sales volume, which helps new manufacturers and new products enter into market; and

7. it facilitates the promotion of product quality competition among manufacturers and improves product quality.

Among these effects, effect (1) requires the existence of cost competition between dealers for customers and space for arbitrage; effects (2) and (3) involve maintaining product reputation and enable consumers to obtain definite pricing information not worthy of highlighting when the buyers are familiar with the product; effect (4) promotes the so-called distribution network construction, which may not benefit consumers; effect (5) takes as a precondition that dealers sell several brands and other brands reduce their prices; and effects (6) and (7) involve promoting the quality of products or services, and encourage new products or new companies to enter the market effect. The agreement's role of promoting competition in the market is more obvious and prominent compared to other effects.

3. Conducting a Comparative Assessment

Third, it's necessary to conduct a comparative assessment of how much overall consumer welfare has been increased. When minimum resale prices maintenance is showing both positive and negative effects, it is difficult for antitrust analysis to make accurate measures of differences between positive and negative effects. Therefore, there must be a clear value target to make a final evaluation of the balance between the positive and negative effects.

Although Article 1 of the AML stipulates that Chinese AML has multiple legislative purposes of maintaining fair competition, improving economic efficiency, safeguarding consumer interests and public interests, etc., in the specific analysis and evaluation of minimum resale price maintenance behavior, safeguarding consumer interests should be the most important legislative goal. Article 15 of the AML stipulates several circumstances that are not applicable to Articles 13 and 14. But such implementation must still satisfy a condition, i.e. "undertakings should also prove that the agreement reached would not severely restrict competition in the relevant market, and would enable consumers to share the benefits arising from such an arrangement." According to this provision, the final condition determining that an alleged conduct is not applicable to Articles 13 and 14 of the AML is that benefits from such conducts can be shared by consumers. This being said, an important criterion for the evaluation of conducts involved in Articles 13 and 14 of the AML is whether such conducts enhance the overall consumer welfare.

For increasing overall consumer welfare, we should be more concerned about the long-term impact of minimum resale price maintenance behavior on consumer welfare:

1. in the long run, as the core mechanism of market competition—price—provides consumers with the most important right to choose. In an effective competitive market, that is, a market where the price mechanism normally plays its role, the voting right is still ultimately owned by consumers. The consumers should always be able to choose goods of reasonable quality, service, and price, thus promoting multiple competitions of price, quality and service, and allowing consumers to benefit therefrom.
2. In the long run, businesses with significant market power or market dominance will set minimum prices of their products above competitive prices, but this may attract other companies to compete on price. The result may be beneficial to the growth of other

competing companies. In this process the consumers have to endure high prices, so consumers' welfare is sacrificed.

3. In the long run, quality improvements, new products, and new companies can increase choices for consumers, and compensate for the loss of consumers in prices, which is the long-term positive effect that can overcome and offset the short-term negative effect of minimum resale price maintenance.

So the general principle to evaluate the effects of minimum resale price maintenance agreement can be further simplified as follows: If no negative effects of limiting price competition is produced, it can be generally considered to not constitute a monopoly agreement that eliminates or restricts competition. If negative effects of limiting price competition are generated without corresponding positive effects of improving product quality and services or promoting new products or new enterprises to enter the market, the minimum resale price maintenance agreement can generally be considered to constitute a monopoly agreement which eliminates or restricts competition.

IV. BURDEN OF PROOF THAT MINIMUM RESALE PRICE MAINTENANCE BEHAVIOR EXCLUDES OR RESTRICTS COMPETITION

Finally, the evaluation and analysis of minimum resale price maintenance behavior determines the allocation of burden of proof for plaintiffs and defendants involved in such conducts in antitrust civil litigations.

An important focus of controversy in the *Johnson & Johnson's* case was how to allocate the burden of proof in evaluating whether the minimum resale price maintenance agreements excluded or restricted competition. The second trial of the *Johnson & Johnson* case explicitly stated that, in antitrust litigation, the plaintiff bears the burden of proof that the minimum resale price maintenance agreements eliminates or restricts competition. The reason cited in the decision is that the burden of proof could be reversed only when explicitly stipulated by laws. Because there is no law and judicial interpretation that make special provisions for whether a minimum resale price maintenance agreement excludes or restricts competition, following the basic principle "burden of proof borne by claimant" in civil litigation, the appellant Ruibang Company bore the burden of proof that the minimum resale price maintenance agreement eliminated or restricted competition.

Meanwhile, regarding the standard of evidence, the decision did not raise extra requirements for the appellant, but believed that the evidence submitted by appellant must tentatively prove that: 1) the appellee had a strong market position in the relevant market and market competition was not sufficient; 2) the motivation of the appellee's minimum resale price maintenance was to limit competition, and 3) the appellee's behavior had the effect of harming competition. If proved, and if the appellee failed to provide sufficient counterevidence, one could determine that the minimum resale price maintenance agreement limited competition and thus constituted a monopoly agreement.

In the second trial of the *Johnson & Johnson* case, in addition to the legal basis cited in the decision to determine the allocation of the burden of proof in evaluating whether the effect of minimum resale price maintenance agreements restricted competition, there were the following considerations:

First, in line with the aforementioned legal evaluation principles, since the maintenance on minimum resale price agreements does not apply the position of "principle of prohibition," it should not allocate the burden of proof to the defendant, otherwise it would assume the principle of prohibition.

Second, assigning burden of proof to the defendant in such antitrust litigation would lower the threshold for such litigation, reduce judicial efficiency, and affect the effective implementation of the AML.

Third, as a given in such proceedings, the plaintiff and the defendant in general have asymmetric information. The plaintiff often doesn't get access to sufficient information. However, the burden of proof is allocated to the plaintiff to prove whether minimum resale price maintenance agreements eliminate or restrict competition. Under the high probability standard of proof in civil action, it is fair for the judge to reduce the requirements of the plaintiff's burden of proof. It also helps realize actual fairness in such litigations.

V. CONCLUSIONS

In summary, in the absence of sufficient empirical evidence indicating that most minimum resale price maintenance behaviors harm competition, for China—an emerging market—it is not a wise choice to adopt either a "*per se* illegal" or "principle of prohibition + exceptions exemption" for minimum resale price maintenance behavior. "Rule of Reason principle" fits the actual needs of the market, but should not be applied in a manner that is too flexible or at too high a cost.

In the second trial of the *Johnson & Johnson* case, the court tried to identify some of the most basic and important analysis elements, so as to provide a simple analytical framework for judges, and also to help enterprises establish clear behavioral expectations. In this analytical framework, the structure of relevant markets, the market position of implementing companies, motives to establish minimum resale price maintenance, and actual competitive effects of minimum resale price maintenance are the most important four factors for judgments. And judges should focus on the effects of market competition that have a substantial impact on the market, and filter out those results that produce non-substantive impact on competition in the market. As a result, this analytical framework can be named the "substantial effect measurement" principle. In this framework, the plaintiff bears the burden of proof with respect to the defendant's substantial damage to competition, but the judge will set the standard of proof based on the specific case.

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What You Need To Know About Standard Essential Patents

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What You Need To Know About Standard Essential Patents

Michael A. Carrier[1]

I. INTRODUCTION

In the past several years, standard essential patents, or "SEPs," have exploded onto the scene. Courts and enforcement agencies around the world have grappled with the nuances they present. What exactly are SEPs? What do attorneys need to know about SEPs?

This article answers these questions. After presenting the setting in which SEPs arise, it addresses three issues: (1) injunctions, (2) antitrust enforcement, and (3) the determination of fair, reasonable, and nondiscriminatory ("FRAND"[2]) royalties.

II. SETTING

Standard essential patents arise in the context of standard-setting organizations ("SSOs"). Standards are common platforms that allow products to work together. They are crucial in fostering interoperability, and are often set by SSOs made up of participants in an industry.

One of the main concerns with SSOs is the risk of holdup. Before a standard is selected, an SSO can choose from an array of alternative technologies. But after the SSO selects a standard incorporating a patented technology, the owner can block others from using the standard by obtaining injunctions or imposing royalties high enough that members are prevented from using the standard. The extent of holdup (or its mirror image, holdout, by which licensees refuse to accept FRAND offers) is a contested issue.[3]

To address any perceived holdup issues, many SSOs have required patentees to agree before the standard is selected to license their technologies on FRAND terms. Such licenses are particularly helpful for SEPs, which are (technically or commercially) essential to the standard. In the smartphone setting, SEPs have covered wireless broadband technologies (such as WiFi), video compression technologies (H.264), and telecommunications standards (4G LTE).[4]

Although they are called standard *essential* patents, not all declared patents actually are essential. Studies have found that patentees overdeclare SEPs, with roughly a quarter of declared

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[2] The FRAND term has been used in Europe, with RAND (reasonable and nondiscriminatory) used in the U.S. I use the more frequently employed FRAND term in this article, though the observations apply equally to RAND.

[3] For a background on standard-setting, *see* MICHAEL A. CARRIER, INNOVATION FOR THE 21ST CENTURY: HARNESSING THE POWER OF INTELLECTUAL PROPERTY AND ANTITRUST LAW 325-44 (2009).

[4] U.S. Dep't of Justice, *Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigations of Google Inc.'s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp., and Research in Motion Ltd.*, Feb. 13, 2012, at 3, http://www.justice.gov/atr/public/press_releases/2012/280190.pdf [DOJ letter].

SEPs actually determined to be essential.[5] Overdeclaration occurs for a variety of reasons, including the avoidance of antitrust risk, reduction of effort in locating SEPs, and boasting of a strong patent portfolio.

III. INJUNCTIONS

One of the most contentious issues surrounding SEPs is whether their owners can obtain injunctions when their patents are infringed. Some judges have contended that—based on the framework articulated by the U.S. Supreme Court in *eBay v. MercExchange*[6]—injunctions are not appropriate because the FRAND promise demonstrates the lack of irreparable harm and adequacy of damages as a remedy. For example, in *Microsoft v. Motorola*, Judge James Robart stated that Motorola was not able to demonstrate irreparable harm because it could receive royalties from Microsoft.[7] And in *Apple v. Motorola* (in an opinion reversed by the Federal Circuit), Judge Richard Posner stated that "[b]y committing to license its patents on FRAND terms, Motorola committed to license [its patent] to anyone willing to pay a FRAND royalty and thus implicitly acknowledged that a royalty is adequate compensation."[8]

After these opinions, the trend moved in the opposite direction, with courts and agencies recognizing that SEP owners sometimes can obtain injunctions. In reversing Judge Posner's decision in *Apple v. Motorola*, the Federal Circuit explained that there is no "*per se* rule that injunctions are unavailable for SEPs."[9] The court found that there was "no reason" to craft a separate rule for SEPs, and that injunctions could be justified "where an infringer unilaterally refuses a FRAND royalty or unreasonably delays negotiations."[10] The Federal Circuit also relied on a January 2013 statement by the Department of Justice ("DOJ") and U.S. Patent and Trademark Office ("PTO") that made clear that injunctions were appropriate against an "unwilling licensee" who (1) refused to pay what was determined to be a FRAND royalty, (2) refused to negotiate, or (3) was not subject to the jurisdiction of a court that could award damages.[11]

One of the complexities in analyzing injunctions is presented by the concept of an "unwilling licensee." In certain cases, such as where a licensee "never meaningfully engage[s] in licensing talks," injunctive relief is typically viewed as justified.[12] But many cases will not be so

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[5] David J. Goodman & Robert A. Myers, *3G Cellular Standards and Patents*, IEEE WIRELESSCOM 2005 (June 13, 2005), (21% of 3GPP and 3GPP2 cellular technologies); Fairfield Resources Int'l, *Analysis of Patents Declared as Essential to GSM as of June 6, 2007* (Jan. 14, 2008), (27% of GSM cellular technology); Fairfield Resources Int'l, *Review of Patents Declared as Essential to WCDMA Through December 2008*, (Jan. 6, 2009), (28% of WCDMA cellular technology).

[6] 547 U.S. 388 (2006).

[7] *Microsoft v. Motorola*, 2012 WL 5993202, at *6 (W.D. Wash. Nov. 30, 2012).

[8] *Apple v. Motorola*, 869 F. Supp. 2d 901, 914 (N.D. Ill. 2012), *rev'd*, 2014 WL 1646435.

[9] *Apple v. Motorola*, 2014 WL 1646435, at *35 (Fed. Cir. Apr. 25, 2014).

[10] *Id.*

[11] U.S. Dep't of Justice and U.S. Patent and Trademark Office, *Policy Statement on Remedies for Standard–Essential Patents Subject to Voluntary F/RAND Commitments,* at 7 (Jan. 8, 2013), http://www.uspto.gov/about/offices/ogc/Final_DOJ-PTO_Policy_Statement_on_FRAND_SEPs_1-8-13.pdf; *see also* Letter from Ambassador Michael B.G. Froman to The Honorable Irving A. Williamson, Aug. 3, 2013, at 2 n.3, http://www.ustr.gov/sites/default/files/08032013%20Letter_1.PDF.

[12] *Ericsson Inc. v. D-Link Systems, Inc.*, 2013 WL 4046225, at *16 (E.D. Tex. Aug. 6, 2013).

clear, with the two sides vigorously debating the issue and pointing to details from the license negotiation. That is why the DOJ/PTO statement emphasized the three categories mentioned above. And, as the Federal Circuit recognized, an overly expansive view of unwilling licensees would fail to recognize that a proposed license "may not be on FRAND terms" and that the public "has an interest . . . in ensuring that SEPs are not overvalued."[13] For that reason, "an alleged infringer's refusal to accept any license offer" does not "necessarily justif[y] issuing an injunction."[14]

Despite the possibility of injunctions, the Federal Circuit in *Apple v. Motorola* denied Motorola's request for an injunction on a standard-essential wireless patent. It found that Motorola's "many license agreements . . . strongly suggest that money damages are adequate" for compensation, that there was not irreparable harm since industry participants were already using the patent, that the parties were engaging in negotiations, and that there was "no evidence that Apple has been . . . unilaterally refusing to agree to a deal."[15]

IV. ANTITRUST ENFORCEMENT: EUROPE

SEP owners that have sought injunctions have recently found themselves in the crosshairs of antitrust enforcement agencies around the world, most directly in Europe.

In 2012, the European Commission ("EC") began an investigation of Samsung, determining whether it breached its obligation to the European Telecommunications Standards Institute ("ETSI") to license its patents related to third generation ("3G") mobile and wireless telecommunications systems on FRAND terms. In particular, the EC examined whether Samsung's attempts to obtain injunctions against competitors constituted an abuse of a dominant position prohibited by Article 102 of the Treaty of the European Union ("TFEU").[16]

In April 2014, the EC accepted a settlement by which Samsung "committed not to seek any injunctions in the European Economic Area (EEA) on the basis of any of its SEPs, present and future, that relate to technologies implemented in smartphones and tablets against any company that agrees to a particular framework for licensing the relevant SEPs."[17] The framework provides for "a negotiation period of up to 12 months," and if the parties cannot agree, it calls for "a third party determination of FRAND terms by a court if either party chooses, or by an arbitrator if both parties agree."[18]

The EC also investigated Motorola Mobility ("MMI") for its conduct related to injunctions after MMI promised to license its mobile and wireless communications patents on

[13] *Apple*, 2014 WL 1646435, at *35.

[14] *Id.*

[15] *Id.*

[16] European Commission, *Antitrust: Commission opens proceedings against Samsung*, Jan. 31, 2012, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/89&format=HTML&aged=0&language=EN&guiLanguage=en.

[17] European Commission, *Antitrust: Commission accepts legally binding commitments by Samsung Electronics on standard essential patent injunctions*, Apr. 29, 2014, http://europa.eu/rapid/press-release_IP-14-490_en.htm.

[18] *Id.*

FRAND terms.[19] In April 2014, the EC found that "it was abusive for Motorola to both seek and enforce an injunction against Apple in Germany on the basis of an SEP which it had committed to license on FRAND terms" where "Apple had agreed to take a licence and be bound by a determination of the FRAND royalties by the relevant German court."[20] The Commission also "found it anticompetitive that Motorola [had] insisted, under the threat of the enforcement of an injunction, that Apple give up its rights to challenge the validity or infringement by Apple's mobile devices of Motorola SEPs."[21] The EC nonetheless decided not to levy a fine because there was "no case-law by the European Union Courts dealing with the legality under Article 102 TFEU of SEP-based injunctions," and "national courts have so far reached diverging conclusions on this question."[22]

V. ANTITRUST ENFORCEMENT: UNITED STATES

SEP owners' attempts to obtain injunctions also have garnered scrutiny in the United States. The Federal Trade Commission ("FTC") has a history of targeting standard-setting conduct, which includes the manipulation of a standard to harm rivals (*Allied Tube*, *Hydrolevel*), deception in failing to reveal required patents (*Dell, Unocal, Rambus*), and increases to predecessors' agreed-upon royalties (*N-Data*).[23]

The FTC turned to the SEP issue for the first time in 2012, entering into a settlement with Bosch, which had threatened an injunction against what the agency found to be a willing licensee. The FTC found that Bosch's predecessor had made a FRAND pledge but had "allegedly reneged on these commitments and pursued injunctions blocking competitors from using the standardized technologies, even though the competitors were willing to license the technology on FRAND terms."[24]

Shortly thereafter, as part of a wide-ranging settlement that centered on Google's search-engine behavior, the FTC required Google (as part of its acquisition of MMI) to follow certain procedures in relation to SEPs. Before seeking an injunction, Google was required to provide a potential licensee with a written offer containing the material license terms and also provide an

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[19] European Commission, *Antitrust: Commission sends Statement of Objections to Motorola Mobility on potential misuse of mobile phone standard-essential patents*, May 6, 2013, http://europa.eu/rapid/press-release_IP-13-406_en.htm.

[20] European Commission, *Antitrust: Commission finds that Motorola Mobility infringed EU competition rules by misusing standard essential patents*, Apr. 29, 2014, http://europa.eu/rapid/press-release_IP-14-489_en.htm.

[21] *Id.*

[22] *Id.*

[23] *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988); *American Society of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556 (1982); *In re Dell*, 121 F.T.C. 616 (1996); FTC Statement, *In re Union Oil Co. of California*, Docket No. 9305 (June 10, 2005), www.ftc.gov/os/adjpro/d9305/050802statement.pdf; *In re Rambus*, No. 9302, 2006 WL 2330117 (Aug. 2, 2006); FTC, Statement, *in re Negotiated Data Solutions LLC*, File No. 0510094, http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

[24] FTC, *FTC Order Restores Competition in U.S. Market for Equipment Used to Recharge Vehicle Air Conditioning Systems*, Nov. 26, 2012, http://www.ftc.gov/news-events/press-releases/2012/11/ftc-order-restores-competition-us-market-equipment-used-recharge.

offer of binding arbitration to determine terms not agreed upon.[25] The agreement additionally made clear that a licensee could negotiate the terms of a license with Google for at least six months and that (if the licensee did not choose this path) Google was not able to seek an injunction unless it provided license terms for at least six months and an option to arbitrate for at least 60 days.[26]

The DOJ also has addressed SEPs, finding in 2012 that competition was "unlikely to [be] substantially lessen[ed]" when it issued a statement explaining why it had approved three acquisitions involving numerous SEPs, specifically:

1. Google's acquisition of MMI's portfolio of 17,000 patents and 6,800 patent applications;
2. Apple's acquisition of the nearly 900 patents originally held by Novell and purchased in 2010 by CPTM (a coalition including Apple, EMC, Microsoft, and Oracle); and
3. Acquisition by the "Rockstar" group (made up of Apple, Microsoft, and RIM) of the 6,000 patents and applications available in the Nortel bankruptcy auction.

Central to the DOJ's approval were the promises made by the acquiring parties to license SEPs. Apple stated that "[s]eeking an injunction would be a violation of the party's commitment to FRAND licensing," and Microsoft promised to "not seek an injunction or exclusion order against any firm on the basis of . . . essential patents."[27] The DOJ concluded: "Apple and Microsoft made clear that they will not seek to prevent or exclude rivals' products from the market in exercising their SEP rights."[28]

The agency also found that Google's acquisition did not substantially lessen competition, but it pointed to a "significant concern" in "how Google may exercise its patents in the future."[29] In particular, Google promised to refrain from seeking injunctions for the infringement of its SEPs, but only for disputes involving future licensing revenues and only if the other party (i) did not challenge patent validity, (ii) paid the full disputed amount into escrow, and (iii) agreed to a reciprocal process for injunctions.[30]

VI. ANTITRUST ENFORCEMENT: CHINA, INDIA, GERMANY

In addition to Europe and the United States, other countries have analyzed antitrust issues related to SEPs. In China, in the case of *Huawei v. InterDigital*, the Guangdong Higher People's Court found that InterDigital violated the Chinese Anti-Monopoly Law by (1) making royalty proposals that the court believed were excessive, (2) tying the licensing of SEPs to non-SEPs; (3) requesting a grant-back of patent rights, and (4) filing an action in the U.S.

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[25] FTC, *Analysis of Proposed Consent Order To Aid Public Comment, In the Matter of Motorola Mobility LLC and Google Inc.*, File No. 121-0120, Jan. 3, 2013, at 6, http://www.ftc.gov/sites/default/files/documents/cases/2013/01/130103googlemotorolaanalysis.pdf.

[26] *Id.* at 7-8.

[27] DOJ letter, *supra* note 4 at 5.

[28] *Id.*

[29] *Id.*

[30] *Id.*

International Trade Commission against Huawei while in licensing negotiations.[31] In a second decision, the court required InterDigital to offer its SEPs on FRAND terms even though it had not made a commitment to do so.[32]

In India, the Competition Commission of India ("CCI") found that Ericsson's imposition of "excessive" and "unfair" royalty rates after making a FRAND promise could be a "prima facie ... abuse of dominance" and violate section 4 of the Indian Competition Act.[33] The excessive pricing had "no linkage" to the patented product, and Ericsson "seemed to be acting contrary to the FRAND terms by imposing royalties linked with the cost of the product."[34] In addition, the CCI found that discriminatory rates could be shown by a company's refusal to share license terms and the "charging of two different license fees per unit phone for use of the same technology."[35]

The legal system in Germany is unique in providing strong protection to patentees, who are able to obtain injunctions unless there is (i) at least a (roughly) 80 percent chance the patent is invalid[36] or (ii) licensees can satisfy the "Orange Book Standard." This standard requires licensees to show that the SEP owner has a dominant position and that the licensee "(1) has made an unconditional offer to license under terms that cannot be rejected by the patent-holder without abusing its dominant position, and (2) [] actually acted as if had entered into a valid patent licence."[37]

As this article went to press, the Orange Book Standard was being reviewed by the Court of Justice of the European Union ("CJEU"). In particular, the CJEU was addressing five questions submitted by the Landgericht Düsseldorf. Most important, the CJEU was considering expanding antitrust liability beyond the narrow setting in which the Orange Book Standard is satisfied to embrace instances in which injunctions were sought against willing licensees.[38] If the CJEU

[31] InterDigital 2013 Annual Report filed Feb. 26, 2013, at 23, *available at* http://ir.interdigital.com/secfiling.cfm?filingID=1405495-13-10&CIK=1405495; October 2013 Judgments, http://www.gdcourts.gov.cn/gdcourt/front/front!content.action?lmdm=LM43&gjid=20140417030902158689 (in Chinese).

[32] *Id.*; *see generally* Koren W. Wong-Ervin, *Standard-Essential Patents: The International Landscape*, ABA SECTION OF ANTITRUST LAW INTELLECTUAL PROPERTY COMMITTEE, 11 (Spring 2014).

[33] CCI Order under Section 26(1) of the Competition Act, 20, *In re Intex Techn. Ltd. v. Telfonaktiebolaget LM Ericsson* ¶ 17 (Jan. 16, 2014), *available at* http://cci.gov.in/May2011/OrderOfCommission/261/762013.pdf.

[34] CCI Order under Section 26(1) of the Competition Act, 2002, *In re Micromax Informatics Ltd. v. Telefonaktiebolaget LM Ericsson* ¶ 17 (Nov. 12, 2013), *available at* http://cci.gov.in/May2011/OrderOfCommission/261/502013.pdf.

[35] *Id.*

[36] Michael A. Carrier, *A Roadmap to the Smartphone Patent Wars and FRAND Licensing*, 4(2) CPI ANTITRUST CHRON. (April, 2012).

[37] European Commission, *Antitrust: Commission sends Statement of Objections to Motorola Mobility on potential misuse of mobile phone standard-essential patents- Questions and Answers* (May 6, 2013), http://europa.eu/rapid/press-release_MEMO-13-403_en.htm; Orange Book Standard (German Federal Supreme Court, May 6, 2009, doc. no. KZR 39/06).

[38] Daniel Hoppe-Jänisch, *The Landgericht Düsseldorf's (Düsseldorf District Court) decision to refer "LTE standard*," WHITE & CASE (Aug. 2013), http://www.whitecase.com/files/Publication/62082331-0a8a-4f06-adcf-7f0363bbdcf0/Presentation/PublicationAttachment/cdf6e92f-9121-48e3-9618-842bfd3d8dbc/Landgericht-

expands the notion of willing licensees, it also will determine if there are "specific qualitative and/or chronological requirements" to the willingness to negotiate.[39] On the other hand, if the CJEU affirms the Orange Book standard, it will determine if "the submission of an unconditional binding offer to conclude a licence" is a requirement for abuse of a dominant market position and if there are particular requirements for the licensee's fulfillment of its obligations.[40]

VII. FRAND ROYALTIES

In the absence of an antitrust violation, one of the most difficult issues presented by FRAND is what constitutes a reasonable royalty. To address this question, Judge Robart set forth a framework in *Motorola v. Microsoft* that has been supplemented by opinions in *In re Innovatio* and *Commonwealth Scientific and Industrial Research Organisation v. Cisco Systems,* and jury verdicts in *Realtek v. LSI* and *Ericsson v. D-Link*.[41]

These rulings articulate a framework of a hypothetical bilateral negotiation between the parties. Such a negotiation would be considered in the context of a modified set of the 15 *Georgia-Pacific* factors for determining reasonable royalties in patent infringement cases. Judge Robart adjusted several of the factors to emphasize: (i) the FRAND setting in determining royalties a patentee could receive, (ii) the contribution of a patented technology separate from its incorporation into the standard, (iii) alternatives to the patented technology, and (iv) the value of the technology to the implementer.[42] The court also underscored the inapplicability of factors relating to a patentee's attempts to maintain a monopoly by refusing to license its patents and (since the patentee cannot discriminate against rivals in a FRAND setting) the commercial relationship between the parties.[43] Most generally, the framework consists of three fundamental steps: (1) the importance of the patent to the standard, (2) the importance of the patent to the alleged infringer's product, and (3) comparable licenses.[44]

Another issue requires the determination of an appropriate royalty base, typically a percentage of the price of the end product or of the patented component. To pick one example, the court in *Innovatio* worried that the calculation of a royalty on an entire product would compensate the patentee for non-infringing components of the product, and thus used WiFi chips embedded in end products as the royalty base.[45]

One approach for determining FRAND royalties that has received attention is the framework Judge Holderman adopted in *Innovatio*. In that case, the judge rejected a "Bottom

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Dusseldorf-District-Court-decision-LTE-standard.pdf; LG Düsseldorf (Düsseldorf District Court) GRUR-RR 2013, 196.

[39] *Id.*

[40] *Id.*

[41] *Microsoft v. Motorola*, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013); *In re Innovatio IP Ventures, LLC Patent Litigation, 2013* WL 5593609 (N.D. Ill. Oct. 3, 2013); *Commonwealth Scientific and Industrial Research Organisation v. Cisco Systems, Inc.*, 2014 WL 3805817 (E.D. Tex. July 23, 2014); *Realtek Semiconductor Corp. v. LSI Corp.*, Case No. C-12-3451-RMW (N.D. Cal., Feb. 26, 2014), http://www.essentialpatentblog.com/wp-content/uploads/sites/234/2014/02/2014.02.27-324-Verdict.pdf; *Ericsson*, 2013 WL 4046225.

[42] *Motorola*, 2013 WL 2111217, at **16-20.

[43] *Id.*

[44] *Id.* at **3-4.

[45] *Innovatio, 2013* WL 5593609, at *14.

Up" approach for calculating the FRAND rate that would determine the price by comparing the patent to reasonable alternatives. Although reasonable in theory, such an approach tends to be "too complicated for courts to perform" because it requires the valuation of numerous SEPs and because "the performance of the standard is multidimensional," with multiple changes resulting from replacing one patent with another.[46]

For that reason, the court adopted a "Top Down" approach that multiplied the average price of the smallest salable component by the average profit margin on that component. It then multiplied this figure by the percentage of Innovatio's standard-essential patents as compared to the total number of such patents. The court explained that such an approach accounted for "royalty stacking" concerns, avoided the need to rely on other licenses, and offered more sophistication than strict numeric proportionality.[47]

Another difference among the courts is their treatment of royalty stacking, the phenomenon that occurs when multiple inputs are supplied by separate firms, with the combination of royalties constituting a significant portion of (or even exceeding) the price of the overall product. The courts in the *Motorola* and *Innovatio* cases recognized such a concern. For example, in *Motorola*, Judge Robart explained that more than 92 entities owned the relevant SEPs, and that if each sought 1.15 percent to 1.73 percent of the end-product price (as Motorola did in the case), the royalty to implement the standard (which was only one feature of Microsoft's Xbox) would have exceeded the price of the entire product.[48] Similarly, in *Innovatio*, the court "consider[ed] royalty stacking as a way of checking the accuracy of a proposed RAND royalty's correspondence to the technical value of the patented invention."[49] In contrast, the court in *Ericsson v. D-Link* was skeptical of royalty stacking, calling it "theoretical" and finding that defendants "c[a]me up empty" when "given the opportunity to present evidence of an actual stack."[50]

In determining an appropriate royalty rate, courts have considered analogues that would be similar to the royalties the parties would have forged through negotiation. Judge Robart did not consider agreements to be comparable if they were conducted as part of a "broad cross-license" or reached in the context of the "threat of a lawsuit" or "history of litigation between the parties."[51] The *Innovatio* court similarly refused to consider potentially comparable licenses that failed to isolate the value of a license from a broader universe of patents that were a small part of a larger settlement, and that were "adopted under the duress of litigation," which led to a payment that could have reflected "hold-up value."[52] In the *Cisco* case, Judge Davis found that a license agreement with a business partner involving business plans, IP rights, R&D contracts, and

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[46] *Motorola*, 2013 WL 2111217, at *13.
[47] *Innovatio*, *2013* WL 5593609, at **37-39.
[48] *Motorola*, 2013 WL 2111217, at *73.
[49] *Innovatio*, *2013* WL 5593609, at *10.
[50] *Ericsson*, 2013 WL 4046225, at *18.
[51] *Motorola*, 2013 WL 2111217, at **67-69.
[52] *Innovatio*, *2013* WL 5593609, at **30-34.

improvements was not comparable to a license that would have emerged from a hypothetical negotiation.[53]

One potential comparable involves patent pools, which involve the licensing of patents from multiple entities as a package. In this context, however, pools present challenges. Royalties tend to be lower than those attained through bilateral negotiation for several reasons: a pool's primary objective is to minimize royalties (not maximize licensing), pools often consider only the number (not value) of patents, and rates are reduced from low transaction costs and antitrust concerns.[54]

The *Motorola* court acknowledged these factors but considered the pool in determining royalties since Motorola's technologies were not important to the standard and since the pool was widely adopted and selected a royalty high enough to attract patentees but low enough to ensure implementation.[55] In contrast, the *Innovatio* court did not consider as comparable a patent pool with "considerably depressed" rates, particularly since Innovatio's portfolio was "of moderate to moderate-high importance."[56]

VIII. CONCLUSION

In short, SEPs present complex issues that are constantly changing. Such issues, relating to injunctive relief, antitrust law, and FRAND, will continue to bear watching around the world in the months and years ahead.

[53] *Cisco*, 2014 WL 3805817, at *10.

[54] *Motorola*, 2013 WL 2111217, at **79-80.

[55] *Id.* at *82, *85.

[56] *Innovatio*, *2013* WL 5593609, at *36.

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Competition, Innovation, and Dynamic Change in the Internet Information Search Industry

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Competition, Innovation, and Dynamic Change in the Internet Information Search Industry

R. Shyam Khemani[1]

I. INTRODUCTION

At the core of the widely acknowledged economic and social benefits accruing from the internet are the internet search engines such as Bing, Google, and Yahoo!, among several others. These search engines act as intermediaries by providing timely and relevant information sought by internet users, and connect those users to suppliers of various products and services.

In the development and evolution of the internet information search industry, there have been marked increases in the number of search engines as well as churning, i.e., entry-exit and changes in their respective ranks. This is to be expected in new, dynamic, fast-changing and innovative industries, especially as the internet and related service providers are generally viewed as still being in the "infancy" stage of development. Without this dynamic competitive process (which the Austrian economist, Joseph Schumpeter termed "creative destruction"), there would be less or no technological change and progress. During any given time period, some firm(s) are likely to emerge as leader(s), while others may decline in their market position or exit. This process is especially characteristic of the internet search engine industry.

Google has emerged as a leading internet search engine in several countries. Various allegations of anticompetitive practices have prompted investigations by different competition authorities. In this regard, we note that most of the investigations are in response to complaints by rivals rather than consumers—contrary to a basic tenet of the objectives of competition law: To protect and promote the competitive process in order to maximize consumer welfare, but not to protect competitors.

In this connection, it is critical for any competition authority investigating alleged dominance and abuse of dominant market position to ascertain if a firm's market position—such as Google's—is a result of anticompetitive business practices in violation of competition law and, further, to establish whether there are appreciable adverse effects on consumers; namely, the principal users of the internet search engine. Equally, competition authorities need to ascertain if a firm's alleged dominant market position stems from "superior competitive performance" over rivals. Finally, they must ensure that competitors are not misusing competition law to: (i) impose costs through unnecessary litigation, (ii) tarnish the leading firm's reputation, and/or (iii) detract its management from better serving its customers.

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[1] Principal, MiCRA. This Note stems from ongoing research by the author. Partial funding provided by Google Inc., is gratefully acknowledged. The views expressed herein are that of the author and do not necessarily reflect those that may be held by his current or past institutional affiliations, nor by Google Inc. The author can be contacted at: sk@micradc.com.

In absence of credible evidence of abusive exercise of "market power" in the case of Google (as against theoretical arguments), the spate of investigations into its alleged anticompetitive business practices poses high risks of competition authorities committing a "Type I error"—alleged violations of competition law that are likely based on a false premise (false positive) of misreading pro-competition business behavior as being anticompetitive. Type I errors adversely impact on legitimate competitive business strategy, raise costs, and have a chilling effect on innovation. In contrast, a "Type II error"—inadvertent failure by competition authorities to prevent anticompetitive business behavior—may have less serious repercussions. This is because market forces provide some corrective power for false negatives—even when one firm has a dominant position, there is still some level of competition to counteract monopolistic behavior.

No corrective force exists for Type 1 errors—regulatory fines are not determined by market forces but discretionally imposed by regulators. Furthermore, fear of false positives creates disincentives for investment in product improvement. This harms both consumers and the competitive process. Moreover, in dynamic, fast-changing, growing, and innovative markets, predicting future outcomes is very difficult. Hence, false positives are not only more damaging, but are more likely to occur—especially, as we point out below, because conventional approaches to defining the relevant market and establishing existence of market power are not easily applicable to two-sided markets such as the internet information search market. Indeed, one of the principal characteristics of such markets is that entry and growth of new or even existing firms is not necessarily path determined. There is disruptive change and today's "leading" firms may be tomorrow's "laggards"—unless they continue to invest and innovate.

In the ensuing discussion we briefly describe some of the complex economic features of the internet search market that need to be considered when assessing competition. We also briefly refer to some decided cases relating to Google, and note that—notwithstanding banner press headlines—in no jurisdiction has Google been charged with violating competition laws.

II. Growth and Structural Change in the Internet Search Engine Market[2]

As the following brief history indicates, Bing, Google, Yahoo!, and numerous other search engines have faced, can continue to face, vigorous competition against each other in the fast-evolving and innovative internet information search market.

Three computer science students at Montreal's McGill University are reputed to have created the first internet (web) search engine—"Archie"—in 1990. It provided a searchable database of downloaded public directory listings. While exact data is not available, presently there exist more than 240 search engines. A time line between 1993 and 2012 suggests that the entry of new internet search engines on average ranges between one and seven new companies per year. During this time some entities have also exited or become inactive, while others have been acquired by existing internet search engines.

[2] The discussion draws on information contained in the following sites: www.thesearchenginelist.com; www.netforbeginners.about.com; www.en.wikipedia.org/wiki/List_of_search_engines; www.en.wikipedia.org/wki/Web_sereach_engine; www.ask.com/question/how-many-search-engines-exist; and various links/articles therein.

Yahoo! established its first search engine (Go.com) in 1994. In 1998, both Google and Microsoft's MSN Search (later Bing) were established. Today, there are numerous general purpose search engines which includes Bing, Yahoo!, Google, Baidu, and others with picturesque names such as "DuckDuckGo," "Dogpile," and "Yippy." Among these search engines, there is a fair degree of differentiation in the search functions provided. For example, "The Internet Archive" allows travel back in time to see what given web pages historically looked like and the information provided; "Mahalo" claims to be "human powered" with a committee of editors that manually vet and sift thousands of pieces of information to provide "high quality" content; "Dogpile," which was originally deemed to be faster and more efficient than Google, is coming back with growing index of clean, quick presentation of content material and crosslinks; and "DuckDuckGo" aims at presenting Spartan search results with less advertisements, among other features.

These, as well as other search engines, have also diversified and/or entered into offering competing services beyond general search functions. There are, for example, several specialized vertical internet search engines focusing on different types of information, products, and services relating to travel, hotels, car rentals, restaurants, shopping, weather reports, accounting, legal, medical, real-estate, maps, etc. Although the main market contested by the general internet search engines is for the larger space of search queries and information, there are no obstacles confronting any of these others in diversifying and broadening their services. Facebook has already evolved beyond being just a social network to provide "Face Time" in competition with Skype, "Facebook Chat" in competition with various sites including "Google+", and work networks allowing for individuals and corporations to link in and advertise, among other features.

III. COMPETITION AND COMPETITIVE DYNAMICS IN INTERNET SEARCH MARKETS

A. "Zero Price," User Pool Size, and Two-Sided Market

Typically, search engines do not charge users for their service. This "zero price" feature enables them to develop a large pool of users. Users searching for specific products, services, and other information reveal what they are currently interested in—whether it is shopping for particular products and services, or for information related to a wide range of topics. This information is of significant value to advertisers as they can target and draw attention of internet users to their offerings, leading to a possible purchase of their product or service.

While the internet search engine is made available at a zero price to users, the costs of operating and constantly upgrading it are recovered from the fees advertisers pay for access to the user pool. Thus, the internet search engine is an intermediary or "platform" operating in a two-sided market that connects internet users on one side and advertisers on the other. It creates value for both sides. The larger the user pool, the more attractive it is to advertisers. The more advertising revenue earned, the more investments and improvements can be made in the internet search engine functions which, in turn, will attract more users.

B. Superior Competitive Performance

The size and growth of the user pool is not automatic. Internet search engines have to invest, constantly upgrade, and innovate if they are to maintain their market position. Google's

position, for example, is attributed to an innovative algorithm "PageRank" method created by the firm's co-founders, along with a host of other complex innovative technologies such as incorporating language models that correct for spelling and grammar and personalized preferences based on past searches, among other algorithms. These algorithms are proprietary, highly confidential, and continuously updated. While some rivals expend higher amounts on R&D, Google recently ranked 2nd (after Apple) among "most innovative companies."[3]

The opportunities for Yahoo!, Bing, and Google, among others, to innovate and challenge each other's market position are only restricted by the caliber and imagination of their respective managers and staff. Yahoo! preceded Google in the internet search market by several years. In 2004, Yahoo and Google had comparable market positions, each with about 35 percent of total U.S. internet search queries. Google, mainly through investments; innovative algorithms; and faster, more efficient, and relevant search results increased its user base to account for about 66 percent of total U.S. internet search queries and had estimated higher shares in Europe, Brazil, and India, among other economies.

As indicated earlier, Google and MSN Search (Bing) were established in the same year. However, Bing, with currently about 17 percent and Yahoo with 12 percent of total U.S. search queries, and even less shares in other countries have, thus far, not been as effective as Google in attracting users. This is despite the fact that both Yahoo! and Bing had the same opportunities at the outset, certainly more financial and human resources, and better-recognized brand names. Being first or having greater financial and human resources does not guarantee sustainable leadership in the market.

C. Organic Search and Search-based Results and Advertising

In response to a search query, the internet user is presented with organic search results and relevant search-based advertising. The organic search results are generated through the search engines' highly confidential proprietary information sorting processes and algorithms. The organic search results are weighted and ranked according to relevance. Sponsored links (or ads) are typically indicated.

Search-based advertising is based on certain keywords used by an internet user and is displayed alongside the organic search results. Search-based advertising is paid for through a system of auctions that may also specify a reserve price. Bids are submitted for certain keyword combinations. The revenue received by the search engine is from the auction and also from the number of "clicks" (visits) by the users to an advertiser's website. In the latter case, the advertiser only pays when a user actually clicks on its ad. The closer the key-word combinations matches the advertiser's business, the more valuable they are and higher bids are submitted in the auction. Thus there is significant competition between bidders for specific key-word combinations.

Of notable interest is that the winning bidder receives the advertising "slot" or space on the search engine's website at the bid price submitted by the second highest bidder. In other words the winner pays less than what it was willing to pay. In economic parlance, the winner

[3] See, *The 2013 Global Innovation Study: Navigating the Digital Future*, *available at* www.strategyand.pwc.com. The other top innovative companies were Samsung, Amazon, 3M, GE, IBM, Tesla, and Facebook. Microsoft ranked 7th.

enjoys "consumer surplus," easily measured by the difference between its bid-price and the second highest bid-price. The second highest bidder, willing to accept a less prominent advertising slot, pays at the third highest bid-price, and so on—all enjoying consumer surpluses. Indeed, an auction represents an efficient and industry- standard method to allocate space on the search page and determine its objective value.

The forgoing practices have become the industry norm. All the major search engines hold continuous auctions whereby advertisers can change their bids frequently, and displace competitors. There are no "lock-in" provisions.

D. Network Effects, Economies of Scale, Switching Costs, and Market Concentration

The competitiveness of a given search engine is determined by a number of factors related to internal capabilities and to external market features. The internal capabilities relate to proprietary and innovative search algorithms, efficient technologies of learning from the results of cumulative searches, and constant upgrading to faster and larger servers. The external factors are "network effects, "which are derived, directly and indirectly, from the size and growth of users and advertisers. The size and growth of users also produce economies of scale and benefits from cumulated learning and experience.

These factors may collectively lead to increased concentration. However, these factors are essentially industry-specific characteristics or requirements of doing business in the internet search engine market. Both economic theory and actual business experience demonstrate that concentration in and of itself does not give rise to competition concerns. As the evolution of Google itself demonstrates, there is no first mover advantage. The search engine Yahoo!, which initially held that distinction, was followed by Altavista. Nor is a high market share position once attained by a search engine inevitably durable, as demonstrated by the displacement of Rambler by Yandex in Russia.

Standard competition analysis would also suggest that (i) unless searchers get locked in to a search engine (e.g., as the default engine initially installed by computer manufacturers) or (ii) that there are high switching costs (which we don't view as true), credible entry into the search engine market is very feasible. This is evident by the proliferation of search engines noted earlier. Market realities are such that internet search engine users can switch search engines instantaneously at zero cost by clicking to the new engine's site (if not previously downloaded, it can be done in minutes) or through an open www link. Users would certainly do this if Google's search engine did not provide superior service.

IV. GAUGING COMPETITION AND MARKET POWER: *Defining the Relevant Market*

The starting point in conducting competition analysis is defining the relevant market. Briefly, the conventional approach adopted by competition authorities is to apply the SSNIP test (small but significant and non-transitory increase in price) to identify the smallest relevant (antitrust) market. They use this market to gauge whether a firm with alleged market power could profitably raise prices by 5 percent or more without customers switching to substitutable or interchangeable products/services. They also judge whether, in this defined market, existing competitors would face barriers that could prevent them from expanding supply or new firms

that could mitigate the price increase would be deterred from entering the defined market. If customers can shift to alternative products, current suppliers can expand, and new suppliers can easily enter the market, the incumbent firm is deemed not to have market power. The market would be considered as being contestable.

In the context of conducting competition assessments of the internet search market, it is critical that its two-sided nature be taken into account for the purpose of defining the relevant market. As mentioned above, in the case of internet search engines there are two groups of active users: searchers and advertisers. A proper approach requires analyzing these two sides together. The normal approach to delineating the market using a SSNIP test is not applicable where the prevailing price is zero, as it is for searchers.

In addition, there are other complexities. The information being sought by an internet user is essentially demand driven and can vary significantly across different internet users, even if they are searching for information broadly relating to the same area. For example, while two or more users may be seeking information on hotel accommodation in London, the specific queries may differ in terms of category, price, and dates (among other factors) such that the vendors/advertisers may not even be in the same market. The information provided in response to each query may be highly customized.

This applies to myriads of other types of information searchers seek. In other words, there is considerable heterogeneity on both the demand and supply sides of internet search markets. As indicated earlier, competition between search engines is in the form of both having superior search results and having a growing endowment of cumulated search results. There are no obvious reasons why search engines would not strive to provide higher quality results to search queries—especially given the wide choice of alternative search sites available.

There are number of other questions that must also be addressed: Do the general information search functions provided by Bing, Yahoo!, Google et al., constitute the relevant market? Does the relevant market include/exclude specialized vertical internet search engines; indeed, is the nature of competition between the general horizontal and specialized vertical search engines understood? How would this competition be gauged given these search functions are provided at zero prices? Are on-line and off-line advertising substitutable, or constitute separate markets? These and other questions have largely remained unresolved.

V. ALLEGED ANTICOMPETITIVE PRACTICES

Due to space restrictions, we synoptically discuss selected decided cases relating to alleged anticompetitive business practices by Google. At the outset it must be noted that in no jurisdiction has Google been charged with violating competition/antitrust law, although in some cases voluntary commitments have been made to address certain issues. There are, however, on-going investigations in several countries.

A. The FTC Investigation

Among the most extensive investigations conducted has been that by the United States Federal Trade Commission ("FTC").[4] The case focused primarily on alleged search bias and exclusivity restrictions on advertisers that prevented "multi-homing," or limited portability of advertising campaign data to competing online advertising sites. Assessing direct and indirect measures of product/on-line advertising space substitutability appeared to have been the FTC's main approach to defining the relevant market.

In general, the FTC determined that while not everything Google did was beneficial for other competitors, the evidence did not support challenges under U.S. antitrust laws. They concluded that the evidence showed it was unlikely Google could manipulate the advertising market and disadvantage competitors. The FTC reiterated that U.S. courts had consistently ruled that the basic tenet of antitrust law was protecting competition and not competitors.

Specifically, the FTC found the following:

- Many of the design changes were found to improve the search results and over-all user experience.
- While online advertising was viewed as being substantially different from off-line advertising such as radio, TV, and print media (newspapers, magazines, etc.), the FTC also stated that all on-line advertising did not constitute the relevant market. There was considerable heterogeneity in on-line advertising such that one type of advertising does not constrain the pricing of another.
- Current competition among competitors was deemed to be vigorous, and Google engaged in competition on its merits.
- The market for on-line advertising space continues to evolve quickly—and its future course is unpredictable.
- As to multi-homing, the FTC found that while most large advertisers were not affected as they preferred to multi-home. Small- to medium-sized firms were less commonly affected.

In 2014, after 19 months, and the examination of nine million documents and extensive interviews with various stakeholders, the FTC closed its investigation of Google's search service without taking any action against Google. However a voluntary consent order was adopted as Google voluntarily agreed to drop restrictions on multi-homing.

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[4] For further information, *see* Statement of the Federal Trade Commission Regarding Google's Search Practices, *In the Matter of Google Inc'* FTC File Number 111-0163*, available at* http://ftc.gov/os/2013/01/130103googlesearchstmtofcomm.pdf; also *see* http://www.ftc.gov/sites/default/files/documents/public_statements/looking-back-moveforward-preserving-progressive-tradition-ftc/130124nysba.pdf; Google Press Conference: Opening Remarks of Federal Trade Commission Chairman John Leibowitz As Prepared for Delivery, January 3, 2013, *available at* www.ftc.gov>News&Events>Speeches.

B. Brazil: Buscape and Bondfaro

In 2012, Buscape and Bondfaro, two Brazilian shopping comparison sites, registered a complaint against Google asserting that Google had 95 percent of the on-line shopping market and manipulated its internet search results in favor of its competing service—Google Shopping. They alleged that searched merchandize was first ranked and displayed on Google Shopping, leading to demoted positions or exclusion of Buscape and Bondfaro. Also alleged was that Google "usurped" the database of client reviews and evaluations for purchases on its own sites, adversely affecting revenues of Buscape and Bondfaro and other associated sites.[5]

The Brazilian Court granted a summary judgment in favor of Google. Applying general legal principles rather than Brazil's competition law, the Court was not persuaded by any of the plaintiffs' arguments and ruled that:

- Google was not a monopoly as there are several search services at the disposal of consumers…looking for products and at the disposal of merchants…to attract consumers (i.e. Bing, Yahoo!, Ask)…..
- Google Shopping is not a shopping comparison site...but one of the 'thematic search options' offered by Google search, and the 'vertical' results are not competitive products but choices made available by Google's search results.
- Google ranks and displays search results that best fit its criteria of quality and relevance to meet users' actual intentions on its algorithmic formula, which is in keeping with its profit corporate business.

C. Hamburg: OneBox

In a similar case as the Brazilian one, the District Court of Hamburg ruled summarily in favor of Google Inc. The plaintiff—a weather service, OneBox—alleged that Google-owned content was biased and displayed in the top spot above the list of organic search results. It maintained that users starting their query with the word "Wetter" (weather) should not have to search further as all the relevant information was contained in their site OneBox. They further claimed that due to a reduced number of visits to its site, the provider received less advertising revenue and, as a consequence, lower profits, which threatened its business model.

The Court ruled that it could not find that Google had "….engaged in unlawful conduct by abusing a position as a dominant market player or as a company with relative market power. Likewise, there is no misleading or otherwise unfair business conduct that would justify a prohibition."[6] Moreover the arguments of reduced visits, advertising revenue, and profitability were not sufficient to establish abusive exclusionary conduct. Also the argument that Google had relative market power was doubtful since there were "effective competitors… such as…..other search engines, some of which are vertical search engines."[7] In addition the Court mentioned that

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[5] The discussion draws extensively on the article by Greg Sterling, *Google Wins Major Antitrust Victory in Brazil: Does it Foreshadow Broader EU & US Wins?* (Sept. 10, 2012), *available at* http://searchengineland.com/.

[6] *Id*. at 2.

[7] *Id*.

companies—such as the plaintiff—operate their own websites independently to attract users and advertisers and were not wholly dependent on Google.

VI. CONCLUDING REMARKS

The internet search market is a dynamic, fast-changing, and innovative market characterized by vigorous competition among various internet search engine providers. The latter play a critical role in the diffusion of knowledge and information and in facilitating commercial transactions. These results, in turn, have led to marked increases in productivity, employment, investment, and the entry of new firms, as well as the creation of new industries, markets, and widespread economic growth—all of which have produced beneficial social, cultural and political changes.

Various allegations of anticompetitive practices have been levied against Google, which has emerged as the leading internet search engine. However, compared with its rivals, who had head starts, greater financial and human resources, and stronger brand names, Google's growth and prominence in the internet search market appears to be due to innovation and superior competitive performance, not illegal competitive practices.

It must be remembered that, when judging the internet search engine market, conventional approaches to defining and analyzing the relevant market and market power cannot be applied given the two-sided nature of the internet search market. Further, in investigating complaints of alleged anticompetitive practices in dynamic and innovative markets such as the internet search engine market, competition authorities face high risks of committing Type I errors of misinterpreting pro-competition business behavior as being anticompetitive. The resulting costs to the market and society can be high since litigation costs are high for both the competition authority and businesses, especially when compared to designing voluntary measures to address reasonable concerns. Finally, it must be emphasized that the fundamental tenet in the administration of competition law is to protect and promote the competitive process—not to safe guard competitors.

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Antitrust Rules and IP Rights in the European Union and the United States—Towards Convergence?

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Antitrust Rules and IP Rights in the European Union and the United States—Towards Convergence?

Mario Todino[1]

I. INTRODUCTION

Over the last years a significant number of high profile antitrust cases raising the issue of how to reconcile competition rules and Intellectual Property ("IP") rights have been investigated in parallel by the U.S. and the EU competition agencies. Most of these cases show an ever-increasing level of convergence, although conventional wisdom still suggests that the approach in accommodating antitrust rules and IP rights is fundamentally different on the two sides of the Atlantic.

In particular, the tough stance taken by the U.S. agencies towards judicial injunctions sought by FRAND-pledged SEPs holders in the smartphone war, and the Supreme Court's ruling in *Actavis,* show that the United States—like the European Union—is progressively departing from a traditional "symmetry" principle which entails that, when applying antitrust rules to IP rights, the latter rights have to be treated and given the same deference as other property rights. The intensity in the application of competition rules increasingly depends on the strength of the IP rights at stake, as well as on the sector involved. And while the EU Commission still shows more boldness in its enforcement actions, at a closer look, differences with the United States tend to be modest and mainly result from different enforcement models.

A significant source of inconsistency, though, may come from the enforcement actions of National Competition Agencies ("NCAs") across the European Union, for some of them—in an attempt to emulate the Commission's bold stance—sometimes take a very intrusive attitude towards IP rights, putting convergence at risk.

The purpose of this article is to concisely compare theories of harms and outcomes of some of the most important antitrust investigations of the last years run in parallel by the United States and the European Union where an intersection between antitrust and IP rules has occurred. It will show that, after all, there is much more convergence between the U.S. and the EU systems than what has been conventionally thought.

II. ANTITRUST VERSUS IP RIGHTS—THE CLASSIC VIEW

Conventional wisdom has it that the approach of the U.S. and EU antitrust agencies when dealing with IP rights is fundamentally different.

In the United States, antitrust enforcement agencies and courts have applied the same principle of symmetry to IP rights as with other property rights, i.e. IP rights do not deserve

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special attention any more than other property rights. Therefore, the same general antitrust principles should apply to conducts involving IP rights that apply to conduct involving any other form of tangible or intangible property.[2] This implies that there is no negative bias and no presumption that IP rights confer market power deserving special attention under antitrust rules.[3]

Instead, in the European Union, when enforcing antitrust rules the Commission and the EU Courts have traditionally shown less deference towards IP rights than the United States. The typical approach spelled out in ECJ case law consists of distinguishing between the existence and the exercise of IP rights. Conditions for granting an IP right as such cannot, in principle, be challenged under Community Law, while the way such rights are exercised can indeed give rise to abusive exploitation of market power or exclusionary forms of unilateral conducts contrary to article 102 TFEU. This has led the Commission to challenge even the most typical ways of exercising an IP right and, therefore, its very essence.

The relationship between antitrust rules and IP rights in the European Union has been historically influenced by two main factors: (1) IP rights have been traditionally tainted with a negative bias given their potential to cause market segmentation along national borders and frustrate the internal market; and (2) the traditional form-based approach in the assessment of unilateral conducts, combined with the special responsibility principle incumbent upon dominant firms, have resulted in the Commission aggressively enforcing competition rules under Article 102 TFUE, [4] including in those areas of intersection between competition rules and IP rights.

This is particularly visible in the area of refusal to deal with rivals, where the *Microsoft* case (*Microsoft* I) has come to epitomize the gap existing between the U.S. and EU systems.[5]

Microsoft (I)

Microsoft (*Microsoft I*) was the first leading antitrust investigation run in parallel by the European Union and the United States that raised the issue of how to reconcile competition rules and IP rights, and is also the case that has most significantly contributed to the perception of a big gap in this area between the two sides of the Atlantic.

In the EU investigation,[6] the Commission challenged Microsoft's refusal to make interoperability information for work group server Operating Systems ("OS") fully available to

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2 See the 1995 guidelines on IP rights jointly issued by the FTC and the DOJ.

[3] On the symmetry principle in the United States, *see* J. Wright & D. Ginsburg "*Whither symmetry? Antitrust analysis of intellectual property rights at the FTC and DOJ*", 9(2) COMPETITION POLICY INT'L. 41 (2013).

[4] Over the last years, the Commission has increasingly departed from a formalistic assessment of unilateral conducts, moving towards an effect based analysis. See Commission's guidance paper on the application of Article 102 TFEU.

5 For a review of the substantive Law applicable in the US and the EU to the refusal to deal in the area of antitrust/IPR intersection, see A. Arena, B. Bergmann J. Himes "*Two bodies of Law separated by a Common Mission: Unilateral Conducst by Dominant firms at the IP/antitrust intersection in the EU and the US" European Competition Journal 9. (2013): 623..*

rivals,[7] and the tying of Windows Media Player ("WMP") with Windows OS.[8] However, the EU investigation mainly revolved around the first conduct, namely Microsoft's refusal to deal with its rivals, an antitrust issue where the distance between European Union and United States could not have been wider.[9]

Under U.S. antitrust law, as a general principle there is no duty to deal with rivals (see *inter alia* S. Ct. in *Trinko*), even less so when IP rights are involved. The argument is that anticompetitive effects stemming from a unilateral refusal to license a valid intellectual property right are a natural consequence of IP Laws themselves.[10]

Under EU antitrust law, the reverse is true. Because of its "special responsibility," a dominant firm has, in principle, a duty to give its rivals access to an input it controls if its refusal results in a significant elimination of competition in the market dependent upon that input. The same principle tends to apply in case the refusal is based on the exercise of a legitimate IP right,[11] although under more exceptional circumstances. The *Magill/IMS*[12] line of jurisprudence had established that a refusal to grant a license by a IPR holder may amount to an abuse of dominance when: (i) the IPR owner enjoys market power, (ii) access to the IPR/input is indispensable for competitors to operate in a market dependent upon such input, (iii) refusal to grant a license risks eliminating all competition from such a market, (iv) there is no objective justification, and (v) the refusal to deal prevents the appearance of a new product.

With respect to the latter requirement, in *Microsoft,* for the first time, the Commission argued that the test would be met not only in those cases where competitors were prevented from marketing products having specified innovative features relative to the existing ones, but also when the refusal to deal prevented rivals from generically innovating through the introduction of competing products.. The General Court upheld the Commission's view: "preventing the

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[6] *See* Commission Decision of 24 March 2004, Case COMP/C-3/37.792, Microsoft, *available at* http://ec.europa.eu/competition/antitrust/cases/dec_docs/37792/37792_4177_1.pdf

[7] According to the Commission's theory of harm Microsoft had strategically refused to disclose relevant interface information needed by rivals active in the market for work group server OS to achieve full client-to-server as well as server-to-server interoperability, with a view to monopolizing the work group server market.

[8] According to the Commission, tying WMP with the dominant Windows would make WMP the platform of choice for complementary content and applications, which in turn would cause foreclosure in the market for media players. Foreclosure would result from content providers standardizing on WMP and forcing consumers to use WMP at some point in time (the "tipping" theory). For a comment on this topic, *see* M. Dolmans & T. Graf, *Analysis of Tying Under Article 82 EC: The European Commission's Microsoft Decision in perspective*, 27(2) WORLD COMPETITION 225-244 (2004) and D.S. Evans & J. Padilla, *Tying Under Article 82 EC and the Microsoft Decision. A Comment on Dolmans and Graf*, 27(4) WORLD COMPETITION 503-512 (2004).

[9] For a review of the substantive Law applicable in the United States and the European Union regarding the refusal to deal in the area of antitrust/IPR intersection, *see* A. Arena, B. Bergmann, & J. Himes, *Two bodies of Law separated by a Common Mission: Unilateral Conducts by Dominant firms at the IP/antitrust intersection in the EU and the US*, 9(3) EUR. COMPETITION J.,. 623 (2013).

[10] For an extensive review of the topic, *see* H. HOVENKAMP, M. JANIS, & M. LEMLEY, IP AND ANTITRUST (2004).

[11] For a review of the topic, *see* V. Korah, *The interface between intellectual property and antitrust: The European experience*, 69, ANTITRUST L.J. 801 (2001).

[12] *See* joined cases C-241/91 and C-242/91 P, *RTE and ITP v Commission*; case C-418/01, *IMS Health GmbH*.

appearance of a new product" is nothing else than limitation of technical development in the broad sense.[13]

The case, as we all know, ended up with a prohibition decision, a huge fine, and intrusive remedies: Microsoft was fined something in the range of EUR 500 million, it was required to disclose to competitors its specification of Windows APIs, and it had to offer a version of its Windows OS without WMP to PC manufacturers/end users.

In the United States, the Department of Justice Antitrust Division ("DOJ") instead challenged different practices, charging both that Microsoft's exclusive dealings with OEM were designed to force Netscape out of the market for internet browsers, and that there was tying between PC OS and Internet Explorer.[14]

The theories of harm were also different. The core of the DOJ's theory was that Microsoft attempted to monopolize the market for internet browsers and was tying its internet browser to its OS in order to protect its quasi-monopoly position in the market for PC OS. Hence, in the Unites States the case was mainly about a maintenance of monopoly claim pursued through commercial behavior typically scrutinized under antitrust rules (exclusive dealing and tying), while there was much more limited discussion about the relevance of IP rights and their possible clash with antitrust rules.

Finally, the outcome/remedies were different. The U.S case ended with a settlement,[15] under which Microsoft was essentially required to refrain from entering into restrictive licensing agreements with OEMs. The tying allegations were dropped after a District Court of Appeal[16] applied the rule of reason test and referred the case back to the competent District Court, which in turn handed down a judgment endorsing the settlement.[17]

The criticism voiced against the EU case still resonates in the antitrust community at large and is not completely groundless. The criticisms included: (i) an excessively lengthy and

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[13] Case T-201/04, *Microsoft v Commission*. For a comment, *see* D. Geradin, *What can the EU learn from the US SC judgment in Trinko in the wake of Microsoft, IMS and Deutsche Telekom*, 41 (6)COMMON MARKET L. REV., 1519 (2004),..

[14] For a comment on the U.S. decision, *see* A. D. Melamed & D.L. Rubinfeld, *U.S. v. Microsoft: Lessons Learned and Issues Raised,* ANTITRUST STORIES, 287-310 (E.M. Fox & D.A. Crane, eds. 2007). Several years after the U.S. investigation was over, the EU Commission challenged the same practices and required Microsoft to take several commitments to put an end such practices (*see* Commission Decision of 16 December 2009, Case COMP/C-3/39.530, *Microsoft*, *available at* http://ec.europa.eu/competition/antitrust/cases/dec_docs/39530/39530_2671_3.pdf.)

[15] Settlement of 2 November 2001. In the settlement Microsoft was also required to provide license communication protocols implemented on Windows PC OS (client-to-server interface information), but there was no obligation to disclose server-to-server interface information.

[16] U.S. DS Court for the District of Columbia, Judgment of 28 June 2001, *US v Microsoft Corporation*, No. 005212. Interestingly, the original intentions of the DOJ were very extreme and would have been probably lethal to Microsoft business model had the Court not rejected the remedy, namely the structural unbundling between the OS business and the applications business.

[17] U.S. DS Court for the District of Columbia, Judgement of 1 November 2002, *US v Microsoft Corporation*, Civil Action n. 98-1233.

unfocused investigation;[18] (ii) a disproportionate fine for a case addressing relatively novel issues; (iii) a somehow speculative theory of harm (the tipping theory with respect to WMP); (iv) an ineffective remedy; and (v) above all, an ever-increasing intrusive approach over IP rights.

In this respect, there is no doubt that the EU decision lowered the thresholds for antitrust intervention in cases of clashes with IP rights. First, *Microsoft* confirms the *Magill/IMS* doctrine in that behind the prevalence of competition rules over IP rights there is also an implicit judgment over the intrinsic quality of the IP rights at stake (in this case finally judged unworthy of protection). Second, it also expands the *Magill/IMS* doctrine, for the legal test is now less demanding: it suffices to prove that a refusal to license an IP right prevents any competing product from entering the market in order for the "new product" test to be fulfilled and the sphere of legitimate IP rights be invaded.

III. THE AREAS OF CONVERGENCE

Although admittedly the duty to deal principle set forth by the *Microsoft* doctrine is still good law in the European Union, and may potentially still have far-reaching implications in future cases, the noise made by, and the visibility of, this case have largely contributed to divert the attention from other important areas of antitrust/IPR intersection where the U.S. and the EU systems appear to head towards convergence.

Interestingly, it is the U.S. System which is coming closer to the EU's as it is moving towards a more interventionist approach[19], possibly under the influence of some distinguished scholars who have started to challenge the idea of IP rights' untouchability and parity with other property rights. First, it has been argued, IP rights are probabilistic in nature: (i) they contain a strong element of uncertainty, (ii) many rest on shaky grounds, (iii) they're issued after a limited examination process, and (iv) they would not stand scrutiny if litigated.[20] Second, IP rights cannot be treated like other property rights since the former may, in some circumstances, confer market power, sometimes even extraordinary market power. Accordingly, strong antitrust enforcement is needed in the presence of strong IP rights.[21] These ideas may have created the favorable intellectual background for a more assertive antitrust intervention in areas such as standard essential patents ("SEPs") in the ICT sector and patent rights in the pharmaceutical sector.

A. Rambus

The first important area of convergence concerns the issue of the deceitful acquisition of Standard-Essential Patents ("SEPs") and the problem of patent hold-up.[22] A patent hold-up

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[18] The investigation lasted more than six years and triggered an endless discussion on what type of IP rights were at stake and what type of interface information should be disclosed to Microsoft rivals.

[19] This is not to say that the US has followed the EU, quite the opposite, US has typically been at the forefront of the debate on the antitrust/IP intersection, with the EU Commission being quicker to put in practice the US principles, also because of the different enforcement models (administrative in the EU).

[20] On the topic, *see* M. Lemley & C. Shapiro, *Probabilistic patents*, (19) J. ECON. PERSP., 75 (2005).

[21] On the topic, *see* M. Lemley, *New balance between IP and antitrust*, SW. J. L. & TRADE AM. 237 (2007).

[22] For an extensive comment on the patent hold-up issues and the *Rambus* case, *see* J. M. Wallace, *Rambus v. F.T.C. in the Context of Standard-Setting Organizations, Antitrust, and the Patent Hold-Up Problem*, 24 BERKELEY

occurs when a patent holder takes part in a standard setting process conducted by a Standard Setting Organization ("SSO") to establish an industry standard and, after having had its patent included in the technology standard retained by the SSO and the standard is in place, threatens to enforce its patent rights to extract supra-competitive prices from firms producing goods which use the standard.[23] *Rambus* was the first prominent case investigated by both the United States and the European Union that dealt with the issue of the deceitful acquisition of SEPs.

In *Rambus* the facts investigated by the two agencies were exactly the same. Rambus was a patent troll (i.e. non practicing entity) that engaged in a so-called patent ambush strategy in the context of the US-based standard setting organization JEDEC. It intentionally concealed its SEPs relevant to technology used in the JEDEC standard for DRAMs, and subsequently claimed excessive royalties for those patents from JEDEC-compliant DRAM manufacturers.

The case started first in the United States, where the U.S. Federal Trade Commission ("FTC") challenged Rambus' deceptive behavior as a form of unfair competition (Section 5 of the FTC Act) and as an attempt of unlawful monopolization (Section 2 of the Sherman Act). However, the FTC decision was quashed by the D.C. Circuit Court on the ground that the FTC had not demonstrated that Rambus' deception of Jedec SSO had directly caused an unlawful acquisition of monopoly power.[24]

In the European Union, the case was investigated later and assessed on a different legal standard. Since Article 102 prohibition does not include conduct resulting in an unlawful acquisition of market power (only the abuse of dominant position can be challenged and not the creation of dominance as such), the Commission challenged Rambus' behavior as a form of exploitative abuse, i.e. a deceptive conduct aimed at extracting monopoly profits from royalties paid by SEPs licensees. However, finding evidence of an exploitative abuse is a very difficult exercise and this case proved to be no exception.[25] This is why at the end, in *dubio* as to having collected sufficient evidence to the requisite legal standard, the Commission opted for settlement

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TECH. L. J. 661-693 (2009); B.H. Kobayashi & J.D. Wright, *Federalism, Substantive Pre-Emption, and Limits on Antitrust: an Application to Patent Holdup*, 5(3) J. COMPETITION L. & ECON. 469-516 (2009); J. Farrell, J. Hayes, C. Shapiro, & T. Sullivan, *Standard setting, patents and hold-up*, 74 ANTITRUST L.J. 603 (2007).

[23] The hold-up problem typically occurs in two scenarios: the patent holder takes part in the SSP and fails to disclose to the SSO the existence of relevant IPR, and then, once the standard is set, attempts to extract large royalty payments under threat of an injunction (the so-called patent ambush). The patent holder first agrees to have its patent included in the standard retained by the SSO in exchange for a commitment to license its patent under FRAND terms, and then attempts to charge locked-in standard compliant manufacturers much higher rates than FRAND terms.

[24] Rambus Inc. v FTC 522 F 3d 456 (DC Cir 2008).

[25] A price can be deemed excessive under the EU case law when it has no reasonable relation to the economic value of the product supplied. This requires a two-stage analysis aimed at examining whether the difference between the costs actually incurred and the price actually charged (the profit margin) is excessive. Investigating a case of excessive prices requires the following analytical steps: collecting costs and revenues of the dominant firm in the relevant market; calculating profits of the dominant firm in the relevant market; comparing such profits to the profits generated either by a competitor in the same relevant market or by the dominant firm in a different (geographic) market acting as competitive benchmark; and demonstrating the disproportion between the dominant firm's profit margins in the relevant market and the fair benchmark profit margin.

with Rambus committing to license patents relating to DRAM technology under Fair, Reasonable, and Non-Discriminatory ("FRAND") conditions.[26]

The interest in this case lies in the fact that the patent hold-up theory of harm inspiring the investigations on both sides of the Atlantic was first developed in the United States and then imported and applied in the European Union—although under somehow different legal grounds. Despite the different outcomes, *Rambus* is the first case showing a similarity of approaches between EU and U.S. agencies in dealing with SEPs corrupted by an element of deception.

B. SEPs and Injunctions

Similar convergence is emerging in the way U.S. and EU agencies are dealing with the injunctions sought by SEPs' holders vis-à-vis willing licensees in the context of the smartphone wars. The facts investigated are the same; all these cases are about the recourse (and enforcement) to injunctions by the owners of SEPs towards potential licensees willing to enter into a license on FRAND terms.

The theory of harm behind the agencies' interventions on both sides of the Atlantic is also by and large the same: Since injunctions generally involve a prohibition of the product infringing the patent being sold, by seeking or enforcing injunctive relief in court against a willing licensee, a SEP holder can impose unfair or unreasonable licensing terms on the licensee and cause significant foreclosure by forcing competitors out of the market. Such a threat can therefore distort licensing negotiations and lead to anticompetitive licensing terms that the licensee of the SEP would not have accepted absent the seeking of the injunction.[27]

As in *Rambus*, however, the legal grounds on which these conducts are challenged are partly different. In the United States the agencies treat these conducts as either an act of unfair competition under Section 5 of the FTC Act, or as an attempt of willful monopolization under Section 2 of the Sherman Act. The EU Commission seems to oscillate between qualifying these behaviors as either a form of exploitative abuse (i.e. an attempt by a dominant firm to extract from its clients supra-competitive profits along the lines of *Rambus*) or as novel cases of exclusionary abuses causing foreclosure.[28]

The outcomes are by and large consistent, save for some nuances: while the U.S. investigations have been closed with settlements,[29] two EU investigations against Apple and

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[26] Commission Commitment Decision of 9 December 2009, Case COMP/38.636, *Rambus*, *available at* http://ec.europa.eu/competition/antitrust/cases/dec_docs/38636/38636_1203_1.pd.

[27] As to the U.S. position on the topic, *see* Statement of The Federal Trade Commission Before the United States Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning "Standard Essential Patent Disputes and Antitrust Law", Washington, D.C., July 30, 2013.

[28] *See* Commission Decision of 29 April 2014, Motorola. For an extensive comment on the legal test applicable to such conducts in the European Union, in particular whether the strict test laid down in the ITT *Promedia* jurisprudence (T-11/96) should apply, *see* N. Petit, *Injunctions for FRAND-pledges SEPs: the quest for an appropriate test of abuse under article 102 TFEU*, 9(3) EUR. COMPETITION J. 677 (2013). *See also* M. Rato & N. Petit, *Abuse of dominance in technology-enabled markets: established standards reconsidered*?, 9(1) EUR. COMPETITION J. (2013).

[29] In the United States, Google has committed to cease seeking injunctions against a willing licensee, either in U.S. federal courts or at the ITC, to block the use of any standard-essential patents that the company has previously committed to license on FRAND terms. *See* Motorola Mobility LLC and Google Inc., F.T.C. File No. 121-0120 (July 22, 2013) at 5, *available at* http://ftc.gov/os/caselist/1210120/130724googlemotorolacmpt.pdf.

Motorola have just ended, respectively, with a settlement (commitment decision)[30] and a prohibition decision without a fine. In the *Motorola* case, in particular, the Commission has ultimately taken a more radical approach than its U.S. counterparts. It held that not only should the threat of the enforcement of an injunction (vis-à-vis its Apple decision) be regarded as abusive, but so should Motorola's insistence that Apple gives up its rights to challenge the validity by Apple's mobile devices of Motorola SEPs.[31]

Besides confirming that the U.S. and EU agencies agree on how to treat patent holds-up, these cases show that the level of convergence has significantly escalated. First, unlike the most blatant forms of patent ambushes, in these cases the deceptive nature of the conduct taken by the allegedly FRAND-pledged SEP's holder is far from being straightforward.[32] Second, the interventionist approach validated by the agencies on both sides of the Atlantic ends up frustrating an essential feature of IP rights, that is protecting the property right vis-à-vis potential infringers by exerting the fundamental right of recourse to justice.

In sum, while the supposedly FRAND-pledged nature of the IP rights at stake should not be underestimated, these cases point to a common trend consisting of a more interventionist antitrust enforcement in those areas where IPRs confer to their holders significant market power, (like in the case of SEPS) and the foreclosure effects resulting from the exercise of such rights can be accentuated by the features of the ICT industry which are conducive to market concentration—namely, direct and indirect network effects, a two-sided market structure, high R&D and fixed costs, and need of interoperability relationships between market actors

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[30] *See* Commission decision of 29 April 2014, Samsung. Samsung has committed not to seek any injunctions in the European Economic Area ("EEA") for a period of five years on the basis of any of its SEPs, present and future, that relate to technologies implemented in smartphones and tablets against any company that agrees to a particular framework for licensing the relevant SEPs. The licensing framework provides for: a negotiation period of up to 12 months; and, if no agreement is reached, a third party determination of FRAND terms by a court if either party chooses, or by an arbitrator if both parties agree. An independent monitoring trustee will advise the Commission in overseeing the proper implementation of the commitments.

[31] *See* Commission Decision case of 29 April 2014, Motorola. In the decision, the Commission has found that it was abusive for Motorola to both seek and enforce an injunction against Apple in Germany on the basis of an SEP which it had committed to license on FRAND terms and where Apple had agreed to take a license and be bound by a determination of the FRAND royalties by the relevant German court. The Commission has also found it anticompetitive that Motorola insisted, under the threat of the enforcement of an injunction, that Apple give up its rights to challenge the validity or infringement by Apple's mobile devices of Motorola SEPs. The Commission has decided not to impose a fine on Motorola in view of the novel issues addressed by its decision.

[32] In the current debate over the legality of injunctions sought by SEPs holders, a prominent role is arguably played by these rights' specific features, that is the FRAND commitments taken in the context of the SSO as a precondition for the patent owner to have its patent inserted in the technology selected as a standard. However, one of the issues hotly debated in the context of the SEPs encumbered technologies and products, is whether in the context of a SSO a precise agreement has been reached about the FRAND terms and conditions under which a SEP can be licensed, or whether only an agreement in principle has been reached, i.e. without defining the exact financial terms. Some commentators also note that the problem of reverse hold-up should not be underestimated, i.e. the possibility that SEP implementers may themselves delay to agree to FRAND to extract better licensing terms from SEP holders. Under all these circumstances, the enforcers' intervention aimed at inhibiting the recourse to an injunction may unduly tip the contractual negotiation in favor of the candidate licensee.

C. Reverse Settlements in the Pharmaceutical Sector

A striking convergence is also emerging in the treatment of reverse settlements in the pharmaceutical sector.[33]

In the European Union, the Commission has not hesitated to challenge—although indirectly—the soundness of the patent rights standing behind these settlements.[34] The Commission has indeed developed a test based on what appear to be "signs of weakness" of the patents involved. In particular, based on the Commission's recent practice, two requirements have to be met in order for such settlements to be deemed anticompetitive by object:

1. The settlement agreement must somehow limit the generic company's ability to enter the market (e.g., through a no-challenge clause, non-compete clause, or the originator licenses where the generic company appoints the originating company as distributor).
2. The agreements entail some value transfer from the originator to the generic company in the form of monetary transfer or in kind (e.g. distribution agreement or license). In this context the size of value transfer is an important factor to consider (i.e. the disproportion between the payment, in whatever form, and the litigation costs and risks) because it signals there may be a profit-sharing mechanism.

While there is ostensibly no inquiry on the validity of the patent, and this issue appears to be irrelevant for the EU assessment, nonetheless, the conclusion is that—present the conditions above—there is an implicit presumption that either (i) the settlement imposes on the generic manufacturer restrictions going well beyond the scope and duration of the patent, or (ii) the patent is weak; that is the patent holder fears its patent does not meet patentability criteria (e.g., granted based on provision of incorrect, misleading, or incomplete information) and, should its patent be challenged in court by the generic manufacturer, it would likely succumb.

Present these conditions, the Agreement will be deemed anticompetitive by object with no need to prove effects. The agreement can still be exempted under Article 101 (3) TFEU, although the burden of proof is on the parties to demonstrate that efficiencies and other redeeming virtues compensate for adverse impact on competition. In practice, this means that

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[33] These are commercial agreements between originators and generic competitors to settle patent-related disputes (dispute/opposition procedure/litigation) concerning the manufacturing and/or marketing of a generic version of a drug which is claimed to be protected by a patent. The theory of harm pursued by the agencies on both sides of the Atlantic is the same: delay of generic entry in return for value transfer with a view to preventing direct competition is a horizontal anticompetitive agreement similar to a price-fixing or market partitioning. i.e. a sharing of monopoly profit.

[34] While in the United States these cases have attracted since some time a lot of scrutiny, in the European Union, these cases came for the first time to the attention of DG Comp in the context of the pharma sector enquiry. To date, there are two pending investigations and two cases recently decided by the Commission: *Lundbeck* (closed with prohibition decision and fine), concerning direct payments, purchases of generic stock, and a distribution agreement when the patent was expired in return for delayed generic entry; *Servier* (recently decided), which concerns alleged direct payment when patent was about to expire in return for delayed generic entry; Cephalon & *Teva* (pending), about alleged direct payment and side deals in return for delayed generic entry; *J&J & Novartis*, recently decided, which concerns a Co-promotion deal.

present these conditions (transfer value and delay of possible entry) illegality presumption is very difficult to rebut.

This approach is by and large equivalent to the U.S. (short form) rule of reason approach recently endorsed by the U.S. Supreme Court in its *Actavis* ruling.[35] The resemblances are strong: The test applied by the Court is whether the settlement of a patent infringement suit entails a large and unexplained payment to a generic infringer. Present this requirement, the settlement can be held unlawful under the rule of reason analysis, i.e. without inquiry as to whether the patent is invalid or not, and even if the settlement does not go beyond the scope of the patent's nominal coverage. Hence, the agencies—or a plaintiff in court—have to demonstrate: i) that the payment from a branded drug manufacturer to a prospective generic exceeds the cost of avoiding litigation, and ii) likelihood of market power and competitive harm.

With respect to the latter requirements, though, the Supreme Court made clear that there is no need to conduct a full scale rule of reason analysis, which traditionally requires definition of a relevant market, demonstration of market power, and anticompetitive effects. In this case, instead it would suffice to take the (large and unexplained) size of payment as a strong indicator of market power[36] and competitive harm.[37] Which is tantamount to say that, once there is evidence of a large and unexplained payment, anticompetitive effects are somehow inherent to the settlement as such. This, in turn, is very close to endorsing an analysis by object only—like in the European Union—in order to reverse the burden of proof upon the parties to the agreement.[38]

It is noteworthy that the analytical framework endorsed by the Supreme Court in *Actavis* is midway between the agencies' radical approaches, suggesting an illegality *per se* of any reverse settlement any time a large and unexplained payment is involved, and the more deferential test that had been devised by several U.S. courts, which revolved around the "scope of the patent." The latter test is based on a presumption of patent validity, i.e. any settlement staying within the scope of the patent (e.g. keeping the generic away from the market until the patent expires) is lawful because the patent standing alone, if valid, would have kept the generic out of the market any way. Under this test, a settlement can be anticompetitive only when the patent dispute is a sham, the patent has been fraudulently obtained, or restrictions clearly go beyond the exclusionary zone of the disputed patent.

Interestingly, although it is clear that in assessing the antitrust legality of reverse settlements there is no need to evaluate the validity of the patent at stake, it is equally clear that, like in the European Union, under the analytical framework endorsed by the Supreme Court in

[35] FTC v. Actavis, Inc., 133 S. Ct. 2223 (2013).

[36] The reasoning is that in a patent dispute a patent holder would pay no more than the anticipated monopoly rents generated by the branded drug over the remaining period. This is why a large payment is indicative of market power.

[37] The reason being that a large payment would be irrational unless the branded drug manufacturer believes the generic drug would significantly reduce its monopoly profits.

[38] Moreover, in pharma cases, existence of market power and effects tend to be easy to demonstrate given that it is very common that a branded drug manufacturer holds a significant share—if not monopoly of the relevant market—and the selling price of brand-name drug is significantly higher than a generic drug, hence the effects of preventing a generic producer from entering the market on prices are significant by definition.

Actavis, antitrust concerns prevail over those of patent law in those cases where the patent is (presumed to be) unworthy of protection—e.g. in those cases where the delay in entering the market agreed in the settlement does not extend beyond the patent coverage and yet the large payment made by branded drug producer to the generic manufacturer to stay away will be taken as indirect evidence of the weakness of the patent.[39]

D. Google

The relatively moderate approach the EU Commission is taking in handling the Google investigation, by and large consistent with the line taken in the United States,[40] is an additional confirmation of this common trend.

Although the antitrust/IPR intersection is admittedly not the main focus of the investigation, among the numerous allegations raised against Google included was Google's alleged attempt to downgrade rivals' interoperability with some of its services through a number of abusive tactics. Actions included in this attempt were: (i) Google's adopting technical measures to restrict competing search engines from properly indexing YouTube links (which Google has recently acquired) on search result pages; (ii) its refusal to allow mobile telephones running Microsoft new Windows phone OS to access YouTube metadata in the same way as Android telephones and IPhones do; and (iii) Google preventing advertisers from using their data in an interoperable way with other search advertising platforms.

Interestingly, like in the United States, the EU Commission also appears to have raised concerns only in connection with the last allegation on the grounds that Google could induce exclusivity and foreclose competing search engines. The other allegations instead are likely to be dismissed, despite the insistence of several complainants claiming much more invasive remedies in the name of the essential facility doctrine—as spelt out in the *Bronner* case law—as well as the *Microsoft* doctrine.

IV. THE NCAs' PRACTICE—*PFIZER*

In the meantime, some recent decisions taken by NCAs remind us that convergence is also an issue to consider within the European Union.

The most exemplary case in this respect is the recent decision for abuse of dominance taken in Italy by the Italian Competition Authority, where Pfizer was heavily fined for having misused administrative procedures and litigation in the context of a complex strategy designed to artificially delay the entry of new generic drug competing with Pfizer's product Xalatan.[41]

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[39] For a comment on Actavis, *see* H. Hovenkamp, *Anticompetitive patent settlements and the Supreme Court's Actavis decision,* 15 (1) Minnesota Journal of Law, 3 (2013).

[40] Although the investigations on both sides of the Atlantic are heading towards a similar settlement (while the EU decision has not yet formally been adopted, the statements issued by Commissioner Almuniapoint to an imminent decision), under the EU's imminent commitment decision, Google seems to have accepted more extensive concessions mainly to address the so called "search bias" charges. Moreover, under the EU's decision some limited remedies have also been offered in connection with the scraping. Conversely, the U.S. settlement is focused on a very limited number of pure antitrust claims (i.e. the issue of exclusivity).

[41] *See* ICA Decision of 11 January 2012, n. 23194. The case has been ultimately upheld by the Conseil d'etat, Judgement of 12 February 2014, *Autorità garante c. Pfizer*, n. 09181.

Although the ICA decision explicitly refers to the abuse of regulatory procedure theory followed by the EU Commission in *Astra Zeneca,* and endorsed by the European Court of Justice ("ECJ"),[42] the facts appear somewhat different. In particular, in *Astra Zeneca* the foundation of the Commission's theory of harm was the fact that Astra Zeneca had obtained patent protection by submitting misleading information to the competent patent agency. In the *Pfizer* case, conversely, it is undisputed that Pfizer employed legal tools provided by the patent system to extend the duration of the protection (a divisional patent). Nonetheless the ICA considered that Pfizer filing an application for a divisional patent—which was a perfectly lawful act under Italian Patent Law—in combination with other conducts (such as launching judicial proceedings against the generic suppliers in order to prevent the sale of the generic, and putting in place other strategies designed to block the entry), constituted an abusive strategy designed to artificially delay a generic competitor from entering the market.

The ICA reasoning was ultimately upheld by the Administrative Supreme Court. The Judge held that a dominant company could not engage in conducts that, although legitimate pursuant to patent laws, have the sole purpose of foreclosing rivals. In this case, according to the Judge, a divisional patent was requested not to obtain a protection for an additional therapeutic use, but rather with the sole aim of extending the duration of the original patent protection and thus hinder the entrance of competitors in the market. The problem with this reading is that it violates the very essence of a patent right. If an originator has obtained a valid patent right without filing inaccurate or misleading submissions with the patent agency, he is entitled to exclude competitors in order to reap the reward of exclusivity without violating antitrust rules.[43]

The novel and alarming development of this case is that it marks a further—and more substantial—invasion of antitrust rules over the sovereign sphere of IP rights. As a result of the *Pfizer* ruling, not only can antitrust rules prevail and nullify IP rights' typical features (i.e. *ius excludendi omnes alios*) in those limited cases where it can be presumed there is something wrong with the patent in the first place (e.g. an inaccurate representation to the Patent Office); but antitrust rules can also challenge perfectly lawful patent rights in those situations where such rights are exercised—possibly in combination with other conducts—with an exclusionary intent, i.e. with a view to preventing competitors' entry. This is tantamount to saying that the existence as such of a lawful patent right is now exposed to antitrust scrutiny, for attempting to protect exclusivity and keep competitors out of the market is the most typical way of exerting a patent right.

V. CONCLUSIONS

In reconciling antitrust rules and IPRs the United States and the European Union have been traditionally regarded as two worlds apart. Under the EU's *Microsoft* doctrine—the argument goes—an IPR holder has an exorbitant duty to deal with competitors as long as it can be demonstrated that the refusal results in significant elimination of competition from the market. The reality is that, despite *Microsoft*, U.S. and EU approaches are increasingly consistent.

[42] Case C-457/10 P, *Astra Zeneca v Commission*.

[43] For a comment of the decision, *see* D. Geradin, W*hen competition law analysis goes wrong, the Italian Pfizer/Pharmacia case* (2014).

In light of the recent developments in the area of judicial injunctions and SEPs, and following the Supreme Court ruling in *Actavis* with respect to reverse settlements, it is now clear that the United States is departing from the traditional symmetry principle under which antitrust rules are applied to IPR exactly the same way as other property rights. There is, in particular, an increasing recognition that IPR cannot be antitrust exempt in an wholesale fashion, as IPRs may deserve special attention due to their specific features (probabilistic nature) and depending also on the relevant economic sector.

Hence antitrust enforcement is becoming increasingly strong when IPRs are (implicitly) judged unworthy of protection (e.g. a weak patent protecting a branded drug which, but for the settlement, would have been otherwise successfully challenged by a generic manufacturer). And it is also strong when IPRs are strong—e.g. SEPs in sectors prone to monopolization due to the specific market features (network effects, two-sided markets, switching costs, etc.).

As to the European Union, although the duty-to-deal principle set forth by the *Microsoft* doctrine is still good law and may potentially have far-reaching implications, as a matter of fact, since *Microsoft*, no cases have been decided based on this doctrine. In the meantime, in other important areas of intersection of antitrust rules and IPR, such as SEPs in the ITC sector and patent rights in the pharma sector, the Commission's cases show a significant level of consistency relative to their U.S. twin investigations. Although, admittedly, in some of the latest investigations the Commission's attitude remains bolder than the United States, the difference is more with the EU administrative enforcement model enabling the Commission to be more assertive in its enforcement action.

What is left as a potential source of inconsistency is the practice of some NCAs across the European Union, which—in an attempt to emulate the Commission's bold stance—may sometimes take decisions having disruptive effects over the very essence of IP rights.

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The Anticompetitive Potential of MFNs

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The Anticompetitive Potential of MFNs

James F. Nieberding[1]

I. INTRODUCTION

Under competition, sellers independently set their prices and often engage in price discrimination by charging different buyers different prices for the same item. However, under a variety of price-protection programs, sellers commit to prices that may limit their pricing freedom by linking prices to some buyers to those charged to other buyers. While such price provisions are known by acronyms such as most-favored-nation provisions ("MFNs"), most-favored-customer clauses ("MFCs"), and meeting-competition clauses ("MCCs"), they all have "price protection" or "price-matching" as a common feature.[2]

For example, a typical MFN provides that a seller will give a buyer the lowest price the seller offers. This can be a promise to protect a buyer against the seller from lowering prices to other buyers or reducing prices in the future, or an assurance to match another seller's lower price. For example, a "retroactive" policy might state that the seller will offer a buyer a refund if future buyers receive a lower price, the reduction being equal to the difference between the present and future prices. A "contemporaneous" policy might stipulate that the seller will offer a buyer the same low price offered to other buyers, effectively committing the seller not to price discriminate. While such provisions seem to epitomize price competition, promise lower prices, and have recognized pro-competitive aspects, they nonetheless have been the focus of antitrust scrutiny for their anticompetitive potential.

This article focuses on the potential anticompetitive aspects of MFNs. A standard price-setting duopoly model is presented to illustrate these concerns and to show that the introduction of an MFN leads to higher prices, reduced output, and increased profitability for all firms—even as they select their actions independently and without explicit coordination. Several antitrust cases are discussed where anticompetitive effects of MFNs were alleged to show that this aspect of MFNs is carefully considered by antitrust enforcers.

II. THE ANTICOMPETITIVE POTENTIAL OF MFNS

A. What Does the Literature Say?

There is a large literature pertaining to MFNs (and similar provisions) and their potential competitive effects. While this literature characterizes under what conditions MFNs can be pro-competitive and efficiency-enhancing (e.g., by reducing various transactions and negotiating

[1] Principal & Founder, North Coast Economics LLC. (http://www.northcoasteconomics.com/).

[2] MFCs and MFNs are guarantees by a seller to give a rebate to a customer if the seller offers lower prices to other customers. An MCC offers to match a lower price that a customer is given by another seller. These (and other) vertical contractual provisions have been termed "contracts that reference rivals" ("CRRs") and can be a source of potential antitrust concern when used by dominant firms. *See* e.g., Jonathan M. Jacobson & Daniel P. Weick, *Contracts That Reference Rivals as an Antitrust Category*, Program on Debating the Competitive Benefits and Costs of MFNs, ABA Section of Antitrust Law (2012).

costs by properly aligning incentives), it also has been shown that such practices can be anticompetitive and used as facilitating devices to sustain higher prices.[3] One concern is that such a contractual obligation may dampen price competition because it raises the seller's cost of cutting prices to buyers not party to the MFN due to the "rebate" owed to protected buyer(s). Another is that MFNs facilitate tacit collusion by generating increased industry profits without formal coordination since enactment of an MFN by one firm induces other firms to raise their price.[4]

In general, there are two types of potential anticompetitive effects related to MFNs (and related provisions) that cut against lower prices.[5] First, MFNs might facilitate higher prices or collusion by giving *sellers* a disincentive to offer price discounts. Such policies can reduce buyers' ability to negotiate for lower prices because the seller finds it expensive to offer selective discounts. This can apply to a single seller that commits to not lowering its future prices because otherwise it must retroactively reimburse buyers subject to the MFN for any price difference. Or, where a seller agrees to charge a price to its protected customers that is no higher than its other customers' prices, an MFN imposes a "punishment" on the seller for decreasing prices due to the requirement to lower all protected customers' prices as a result.

With respect to oligopoly behavior, the inherent rebate mechanism in an MFN creates a penalty for "cheating" on a collusive agreement (tacit or explicit). As a result, coordinated pricing has been shown to be more stable than if no MFN were used. Moreover, if a major seller offers a price-protection policy to its buyers by promising to match competitors' price cuts, competitor discounts become less profitable as they no longer expand sales to the extent they would absent the price-match guarantee. In other words, a firm offering a price-matching commitment to its customers is signaling to its competitors that any lower price from them would be matched and diminish any gains from the price cut. The concern is that these types of agreements offered by sellers raise the cost to them of giving selective price discounts, which result in higher prices or increased price rigidity but-for the MFN.[6]

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[3] For a recent summary of the competitive aspects of MFNs and their treatment under U.S. antitrust law, *see* Jonathan B. Baker & Judith A. Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, 27(2) ANTITRUST, 20-26 (Spring 2013); and Steven C. Salop & Fiona Scott Morton, *Developing an Administrable MFN Enforcement Policy*, 27(2) ANTITRUST, 15-19 (Spring 2013). A detailed study of MFNs, MFCs, and MCCs can be found in *Can 'Fair' Prices Be Unfair? A Review of Price Relationship Agreements*, Office of Fair Trading (OFT), (September 2012). This OFT document contains a listing of the literature pertaining to MFNs and similar provisions (pp. 124-134). In September 2012, the DOJ's Antitrust Division and the FTC held a public workshop on the effects of MFNs and the implications for antitrust policy and enforcement. *See* http://www.justice.gov/atr/public/workshops/mfn/.

[4] *See*, e.g., Thomas E. Cooper, *Most-Favored-Customer Pricing and Tacit Collusion*, 17(3) RAND J. ECON. 377-388 (1986); and Aaron S. Edlin, *Do Guaranteed-Low-Price Policies Guarantee High Prices, and Can Antitrust Rise to the Challenge?* 111 HARV. L. REV. 528-575 (1997).

[5] While prominent in the literature, these are not the only anticompetitive theories related to MFNs. A seminal paper is Steven C. Salop, *Practices that (Credibly) Facilitate Oligopoly Co-ordination*, NEW DEVELOPMENTS IN THE ANALYSIS OF MARKET STRUCTURE 265-290 (J. Stiglitz & F. Mathewson, eds. 1986).

[6] A recognized difficulty with enforcing the provisions of an MFN is whether or not price discounts (or other competitive concessions) are readily discernible to all interested parties.

Second, MFNs might be used by a dominant *buyer* to gain market power at the expense of rival buyers through exclusion or, more generally, by raising their rival buyers' costs. The concern is that such an MFN might disadvantage rivals to the dominant buyer who might otherwise negotiate lower prices than those of the dominant buyer. This is because it raises the cost to the seller(s) of giving lower prices to other buyers as the seller(s) must rebate any price difference to the dominant buyer. Because MFNs typically mandate that lower prices to one customer be made available to all parties to the MFN, price discounting may not occur to the extent it would absent the price protection. Moreover, if a dominant buyer has an MFN with many sellers in a given market that "penalizes" sellers from giving more favorable rates to other buyers, entry (or expansion) by rivals to a dominant buyer may be deterred.

The literature also describes possible strategic uses of MFNs to achieve higher prices. For example, Cooper & Fries present a bargaining model to assess the effect of an MFN on equilibrium prices where a single seller negotiates sequentially with two buyers.[7] In their model, the dominant seller negotiates over price first with "Buyer 1" and then with "Buyer 2." It is shown that the seller can use an MFN with Buyer 1 to leverage more favorable terms such as higher prices from Buyer 2. This is because the seller can credibly claim with an MFN that it cannot give Buyer 2 a "low price" because doing so would force the seller to also lower Buyer 1's price. Absent an MFN, the seller would not be able to make such a claim. Consequently, the seller's incentive to discount its price to Buyer 2 is diminished and the seller is able to negotiate a higher price with the second buyer than without the MFN.

B. An Illustrative Example of the Anticompetitive Potential of MFNs

A simple model of a retroactive MFN is presented—using a numerical example—to illustrate the potential anticompetitive aspect of such a policy found in the literature.[8] Assume two firms—Firm M and Firm N—comprise a market and engage in Bertrand competition with differentiated products for two periods. For simplicity, assume that both firms have identical marginal costs (equal to zero), demand is linear in each period where $q^M = (a - bp^M + dp^N)$ and $q^N = (a - bp^N + dp^M)$, and there is no possibility of entry or exit.[9] Firm M offers the MFN policy to its customers whereas Firm N does not. Specifically, Firm M agrees that if its Period 2 price is less than its Period 1 price (i.e., $p_2^M < p_1^M$), it must rebate its customers in Period 1 this price difference multiplied by Period 1 output (or purchases), q_1^M.[10] Given this setup, Firm M's Period 2 profits are:

(1) $$\pi_2^M = p_2^M(a - bp_2^M + dp_2^N) - \left((p_1^M - p_2^M)(a - bp_1^M + dp_1^N)\right)$$

The last term in (1) represents the MFN "penalty" incurred by Firm M should $p_1^M > p_2^M$. Firm M's Period 1 profits are:

[7] Thomas E. Cooper & Timothy L. Fries, *The Most-Favored-Nation Pricing Policy and Negotiated Prices*, 9 INT'L J. INDUS. ORG. 209-223 (1991).

[8] More detailed models with these findings can be found in William S. Neilsen & Harold Winter, *Bilateral Most-Favored-Customer Pricing and Collusion*, 24(1) RAND J. ECON, 147-155 (Spring 1993); and Kazuhiro Ohnishi *An Oligopoly Model with Donative Most-Favored-Nation Pricing*, 2(3) INT'L J. ECON. MGMT. ENGIN. 104-107 (2012).

[9] Standard assumptions are assumed to hold for the parameters in the demand function (i.e., $a > 0$, $b > d > 0$).

[10] Superscripts refer to either Firm M or Firm N and subscripts refer to either Period 1 or Period 2.

(2) $\pi_1^M = p_1^M(a - bp_1^M + dp_1^N)$

Firm N's Period 1 and Period 2 profits are, respectively:

(3) $\pi_1^N = p_1^N(a - bp_1^N + dp_1^M)$

(4) $\pi_2^N = p_2^N(a - bp_2^N + dp_2^M)$

The four equilibrium prices (i.e., $p_1^M, p_2^M, p_1^N, p_2^N$) are obtained by simultaneously solving the "first-order conditions" for profit maximization from expressions (1)-(4).[11] These prices are then used to solve for the corresponding optimal outputs (i.e., $q_1^M, q_2^M, q_1^N, q_2^N$) and maximal profits (i.e., $\pi_1^M, \pi_2^M, \pi_1^N, \pi_2^N$). These prices, outputs, and profits are then compared to those resulting from the differentiated products Bertrand model where neither firm offers the MFN to its customers.[12]

Since the equilibrium values for prices, outputs, and profits are a function only of the demand parameters *a*, *b*, and *d*, a numerical example helps to illustrate the concern regarding the potential anticompetitive effect of MFNs. As illustrated in Table 1 and assuming $a = 50$, $b = 3$, and $d = 1$, the prices, outputs, and profits in each period (for both firms) without Firm M's MFN are $10, 30, and $300, respectively.[13] Without the MFN in place, because there is no "link" of prices between Period 1 and Period 2, these equilibrium values for prices, outputs, and profits represent the non-cooperative, single-period Bertrand outcome. These are the benchmarks for the comparison of the market outcome with Firm M's MFN in place. As seen in Table 1, with the MFN in place, while Period 1's market outcome is identical to that absent the MFN, Period 2's outcome is not.

Several key results emerge from the comparison of market outcomes with and without Firm M's MFN in place.

- Firm M's Period 2 price is higher than its Period 1 price, and also higher than its Period 2 price without the MFN ($15.14 > $10).
- Firm N's Period 2 price is higher than its Period 1 price, and also higher than its Period 2 price without the MFN ($10.86 > $10).
- Because the increase in Firm N's Period 2 price ($0.86) is less than Firm M's Period 2 price increase ($5.14), Firm N's Period 2 prices are relatively lower than Firm M's. As a result, Firm N's Period 2 output is higher than in Period 1 (32.57 > 30). However, Firm

[11] The software *Mathematica 9* was used to generate all solutions discussed in this paper (results are available from the author upon request). In optimization problems such as profit maximization, a "first-order condition" is the first derivative of the objective function (here, each firm's profit function) with respect to the choice variable (here, each firm's price). First-order conditions equal to zero are necessary (but not sufficient) for the optimal value of the choice variable.

[12] For the non-MFN model, the only difference is that Firm M's Period 2 profit function in (1) does not contain the MFN "penalty" term.

[13] For example, without the MFN, $p_1^M = p_1^N = p_2^M = p_2^N = \frac{a}{2b-d}$ = $10 (assuming $a = 50$, $b = 3$, and $d = 1$). The results discussed in this Bertrand model are independent of the values of *a*, *b*, and *d*.

M's Period 2 output is lower than it would be without the MFN (15.43 < 30). Because the decrease in Firm M's output (-14.57) exceeds the increase in Firm Ns output (2.57), total output is lower in Period 2 than in Period 1, and also lower than Period 2's output without the MFN (48 < 60). As a result, total output over both periods is lower with the MFN than without it (108 < 120).

- Firm M's profits are higher with the MFN than without it ($688 > $600), as are Firm N's profits ($654 > $600).

Table 1: Comparison of Output, Prices, and Profits

($a = 50$; $b = 3$; $d = 1$)

	Firm M	Firm N	Total	Firm M	Firm N	Firm M	Firm N	Total
MFN	Output	Output	Output	Prices	Prices	Profits	Profits	Profits
Period 1	30	30	60	$10	$10	$300	$300	$600
Period 2	15.43	32.57	48	$15.14	$10.86	$388	$354	$742
Total	45.43	62.57	108			$688	$654	$1,342
No MFN								
Period 1	30	30	60	$10	$10	$300	$300	$600
Period 2	30	30	60	$10	$10	$300	$300	$600
Total	60	60	120			$600	$600	$1,200

A variant in the literature to the above price-setting duopoly with differentiated products is presented by Cooper.[14] He illustrates that if a firm offers an MFN (or similar price protection policy), then charging a price slightly above the Period 1 equilibrium price (without the MFN) commits the firm to maintaining that price into the future. The firm is incentivized to not lower its future price (in Period 2) because the rebates required by the MFN outweigh the gains from the price decrease. Moreover, the MFN induces the other firm to raise its price, and both firms can earn greater profits if only one offers the policy. Therefore, a firm has an incentive to adopt the MFN unilaterally. In the context of his model, Cooper shows that in equilibrium at least one firm offers price protection and both firms earn greater profits, all without explicit coordination.

III. ANTITRUST CHALLENGES INVOLVING MFNS

MFNs and similar contractual price-matching guarantees are not new to antitrust scrutiny. Thirty years ago the FTC in the 1984 *Ethyl* case challenged the use of such clauses (among other things) involving four manufacturers of lead-based antiknock compounds.[15] The FTC's allegation was that the price-protection policy created an incentive for the firms with it to

[14] Thomas E. Cooper, *supra* note 4 at 377-388.

[15] *In the Matter or Ethyl Corporation, et al., 101 F.T.C. 425.* A detailed discussion of the *Ethyl* case can be found in G.A. Hay, *Practices that Facilitate Cooperation: The Ethyl Case*, THE ANTITRUST REVOLUTION: THE ROLE OF ECONOMICS, 2ND ED., 189-213 (J. E. Kwoka, Jr. & L. J. White eds. 1984.). *See* also, JEFFREY CHURCH & ROGER WARE, INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH, 525-526 (2000).

be less aggressive price cutters, leading to higher overall prices. The claim was that these firms increased the cost to themselves of discounting because a price concession to one customer would have to be matched by price cuts to all protected customers.

There is a track record of antitrust scrutiny of MFNs in the healthcare industry where their use is prominent.[16] Health insurers frequently require healthcare providers to guarantee that insurers receive the lowest rates from their providers. These MFNs often stipulate that a provider offer the insurer the lowest cost for services that it makes available to any other insurers. For example, in 1996, the DOJ challenged the MFN clause contained in contracts between Delta Dental of Rhode Island and the vast majority of Rhode Island dentists. Under that MFN, contracting dentists agreed to let Delta limit payments to them to the lowest price that the dentists charged to any other customer. The DOJ alleged that Delta's MFN discouraged Rhode Island dentists from discounting their fees to rival dental plans below levels paid by Delta as doing so would force the dentists to also cut their fees to Delta.[17]

The concern about the anticompetitive effect of the MFN in *Delta Dental* was in contrast to *Ocean State* where the court found that the MFN (called the "Prudent Buyer" policy) did not run afoul of antitrust laws, and should be viewed as "legitimate business activity."[18] A more recent example related to healthcare is the 2010 commission appointed by the Ohio General Assembly to examine the competitive effects of MFNs in health insurance contracts which recommended they be prohibited in all Ohio contracts between health insurers and healthcare providers.[19]

Recently, several high-profile cases have focused on antitrust issues related to MFNs. For example, MFNs have been in the news regarding various DOJ investigations of Blue Cross Blue Shield's ("BCBS") contracts with healthcare providers and in the Apple e-book matter.[20] In Michigan, for example, BCBS is a significant buyer of hospital services supplied by health care providers. The challenged conduct was that BCBS entered into MFNs (and variants thereof) with

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[16] *See*, e.g., Joseph A. Martin, *Antitrust Analysis of 'Most Favored Nation' Clauses in Health Care Contracts*,' Private Antitrust Litigation News, ABA Antitrust Section (2000); and William Lynk, *Some Basics About Most Favored Nation Contracts in Health Care Markets*, 45 ANTITRUST BULL. 491-530 (2000).

[17] *See* http://www.justice.gov/atr/cases/f0800/0841.htm. This case was settled by Consent Decree where Delta agreed to drop the MFN.

[18] *Ocean State Physicians Health Plan, Inc. v. Blue Cross and Blue Shield of Rhode Island*, 883 F.2d 1101 (1st Cir. 1989). *See* http://law.justia.com/cases/federal/appellate-courts/F2/883/1101/350683/. The district court granted Blue Cross' motion for judgment notwithstanding the jury verdict (upheld on appeal). While determining that the MFN tended to "further competition on the merits," the district court enumerated several factors that might make an otherwise pro-competitive MFN into an anticompetitive, exclusionary practice. *See*, e.g., Kate. A. Ball & Charles S. Wright, *Most Favored Nations Clauses Reexamined in Light of DOJ Challenge in Michigan*, Members Briefing, American Health Lawyers Association (2011).

[19] James M. Burns, Joseph R. Pope, & Williams Mullen, *Most-Favored Nation' Clauses and Health Insurers*, LAW360, (April 23, 2010). The report is entitled *House Bill 125 Joint Legislative Commission on Most Favored Nation Clauses in Healthcare Contracts Report*, 2010, Ohio Department of Insurance. *See* http://www.insurance.ohio.gov/Legal/Reports/Documents/MFN%20Report-%202010.pdf.

[20] *See*, e.g., Leo A. Caseria, *In Case You Missed It…MFNs and RPMs: The Antitrust Spotlight is on Price Relationship Agreements*, 10(2) ABA ANTITRUST SECTION JOINT CONDUCT COMMITTEE E-BULLETIN, 16-20 (Summer 2013); Joe Palazzolo, *Apple Ruling Heaps Doubt on 'MFN' Clauses*, WALL ST. J., (July 14, 2013); and Thomas Catan & Avery Johnson, *Justice Widens Blue Cross Probe Across Several States*, WALL ST. J., (March 26, 2011).

a large number of hospitals to raise rival insurers' costs, thereby reducing their ability to compete with BCBS in offering health insurance, which caused higher prices. As the DOJ complained, "Blue Cross' use of MFNs has reduced competition in the sale of health insurance in markets throughout Michigan by inhibiting hospitals from negotiating competitive contracts with Blue Cross' competitors."[21] The DOJ further alleged, "Blue Cross sought to insulate itself from competition in health insurance markets throughout Michigan by entering into 'most favored nation' agreements ('MFNs') with more than 70 hospitals" with "dramatically higher prices resulting from the MFNs."[22] The DOJ claim is consistent with concerns that a dominant buyer (BCBS) may impose an MFN to disadvantage its rivals (competing health insurers). As stated by DOJ:

> A hospital that would otherwise contract with a competing insurer at lower prices than it charges Blue Cross would have to lower its prices to Blue Cross pursuant to the MFN if it sought to maintain or offer lower prices in contracts with other commercial insurers. The resulting financial penalty discourages a hospital with a Blue Cross MFN from lowering prices to health insurers competing with Blue Cross.[23]

The court in *Apple*, which examined Apple's agreements with e-book publishers containing MFN provisions (in addition to examining other issues such as the agency model for distributing e-books), found that the MFN reduced retail price competition. The court characterized the challenged pricing practice as follows, "The MFN guaranteed that the e-books in Apple's e-bookstore would be sold for the lowest retail price available in the marketplace," and that it "required publishers to match in Apple's iBookstore any lower retail price of a New Release offered by any other retailer."[24] The court ultimately found, "the MFN protected Apple from retail price competition as it punished a Publisher if it failed to impose agency terms on other e-tailers."[25]

Such a finding is consistent with the view that an MFN can be a facilitating device used by sellers to credibly commit to imposing a penalty on themselves for offering a lower price to some customers, thereby discouraging price competition. While the court did not explicitly address the legality of MFNs under antitrust law, it did determine that the circumstances surrounding them in Apple—notably Apple's participation in a horizontal price-fixing scheme—made for an unreasonable restraint of trade, and that Apple violated Section 1 of the Sherman Act by enabling a horizontal conspiracy among e-book publishers.[26]

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[21] DOJ *Complaint* in the BCBS Michigan matter (joined by the Michigan AG's office), p. 1 (October 18, 2010). *See* http://www.justice.gov/atr/cases/f263200/263235.pdf. On March 25, 2013, DOJ filed a motion to dismiss its antitrust lawsuit BCBS because Michigan passed a law that prohibits health insurers from using MFNs in contracts with health care providers. *See* http://www.justice.gov/opa/pr/2013/March/13-at-345.html.

[22] *Plaintiff United States Of America's Memorandum In Opposition To Defendant Blue Cross Blue Shield Of Michigan's Motion To Dismiss The Complaint With Prejudice*, 11, 29 (January 20, 2011). *See* http://www.justice.gov/atr/cases/f266300/266327.pdf.

[23] DOJ Complaint in the BCBS Michigan matter (joined by the Michigan AG's office), 21 (October 18, 2010).

[24] Opinion and Order, *United States of America v. Apple, Inc. et. al*, 45, 52 (July 10, 2013).

[25] *Id.*, p. 55.

[26] The court stated, "While vertical restraints are subject to review under the rule of reason, Leegin, 551 U.S. at 907, Apple directly participated in a horizontal price-fixing conspiracy. As a result, its conduct is per se unlawful.

The 2014 decision in the *Online Travel (OTC) Hotel Booking Antitrust Litigation* dismissed a federal antitrust lawsuit (whose claims included an MFN) that alleged a conspiracy to fix online prices of hotel rooms by hotel companies and online travel agencies ("OTAs").[27] Here, the MFN provision involved a clause in a resale price agreement ("RPM") "that prevent[ed] the Hotel Defendants from offering lower published prices on any other website, including the websites of other online travel agencies, and their own websites… [and] provides the hotel will not offer a lower price to a competitor of the online travel agency."[28] While not explicitly ruling on the permissibility of the RPM and MFN clause, the court did conclude that such a policy "made perfect economic sense."[29] The court stated:

> Having given up the right to discount prices below each Hotel Defendant's published rate, each OTA Defendant would naturally want an assurance that competitors will also be prohibited from offering a lower price than the published rate. That is precisely what each OTA Defendant got in return according to the Complaint—an MFN clause assuring the OTA Defendant that the minimum rate it must publish will not be undercut by the hotel itself or an OTA competitor.[30]

Ultimately, the court ruled that since only intra-brand competition among a given hotel's online distribution channels was at issue (and not inter-brand competition between competing hotel brands), the challenged conduct was not anticompetitive.

IV. CONCLUSION

While U.S. antitrust agencies recognize that MFNs may be pro-competitive or anticompetitive depending on circumstances,[31] the literature has shown—and antitrust cases have emphasized—that such provisions may have anticompetitive effects. However, general conclusions about whether MFNs are pro-competitive or anticompetitive are of little assistance in analyzing whether a particular MFN (or its variants) runs afoul of antitrust laws. Therefore, like any commercial practice analyzed under a "rule-of-reason" approach, there needs to be a careful balancing of the efficiency versus anticompetitive effects, with the outcome for any particular MFN dependent on the specific facts of the challenged conduct.[32]

The agreement between Apple and the Publisher Defendants is, 'at root, a horizontal price restraint' subject to per se analysis." Opinion and Order, *United States of America v. Apple, Inc. et. al*, 153 (July 10, 2013). For a discussion of several unique aspects related to Apple's MFN, *see* Adam Scott Kunz, *The Ringmaster's Whip: The Role of Apple's MFN Under Toys "R" Us in the E-books Case*, 13(1) THE PRICE POINT, 7-10 (Winter 2014).

[27] *See*, e.g., Lindsay C. Harrison & Kelly M. Morrison, *Major Victory for Hospitality Cos. In Antitrust Suit*, LAW 360, (February 21, 2014).

[28] Consolidated Amended Complaint, *Online Travel (OTC) Hotel Booking Antitrust Litigation*, 6, 29 (May 1, 2013).

[29] Memorandum and Opinion Order, *Online Travel (OTC) Hotel Booking Antitrust Litigation*, 16 (February 14, 2014).

[30] *Id.* p. 17.

[31] *Improving Health Care: A Dose of Competition*, A Report by the Federal Trade Commission and the Department of Justice, Ch. 6, p. 20 (July 2004).

[32] As stated by Lynk (2000), *supra* note 17 at 502, "[t]heory can tell us what effects to expect and to look for ... but only factual investigation can determine whether in any actual market the balance of consumer benefits from MFNs is positive or negative."