International Chamber of Commerce
The world business organization

Single-Firm Conduct As Related to Competition

Prepared by the Commission on Competition

Submission to the US Federal Trade Commission and Department of Justice Hearings on Section 2 (project no P062106) of the Sherman Act

ICC, the International Chamber of Commerce, and the USCIB, United States Council for International Business, welcome the opportunity to submit comments to Federal Trade Commission and Department of Justice Hearings on Section 2 of the Sherman Act regarding certain antitrust issues that have been identified for potential study.

As world business organizations with members from all sectors in over 130 countries, ICC and USCIB are able to draw on a rich range of perspectives from different sectors on these issues. With their long history of interest in the issues below, it is hoped that the following comments may assist the hearings to identify priority areas for further work. The issues identified and questions presented in the Federal Register notice have been previously addressed in recent comments submitted by ICC and the USCIB, specifically in the International Chamber of Commerce, *Comments on the Reform of the Application of Article 82 of the EC Treaty*[1]; the *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* [2]; the International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission;*[3] and the United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses*.[4] Rather than repeat this material in its entirety, ICC and USCIB direct the staff to them generally, and here include only highlights addressing particular issues and questions presented in the Federal Register notice.

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1 Document No. 225/623 (12 December 2005),available at http://www.iccwbo.org/uploadedFiles/ICC/policy/competition/Statements/Comments%20on%20the%20Reform%20of%20the%20Application%20of%20Article%2082%20of%20the%20EC%20Treaty.pdf

2 Document No. 225/627 (7 April 2006), available at http://www.iccwbo.org/uploadedFiles/ICC/policy/competition/Statements/ICC_Comments%20EC%20Article%2082.pdf

3 Document No. 225/621 (1 September 2005), available at http://www.iccwbo.org/uploadedFiles/Submission_%20to_%20the_%20AMC.pdf

4 (30 March 2006), available at http://www.uscib.org/docs/Final_USCIB_Article82.pdf

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A. Bundled Loyalty Discounts and Market Share Discounts:

1. How should the structure of the market and the market shares of participants be taken into account in analyzing such conduct?

There is no basis for the premise that all rebate systems established by a dominant undertaking are abusive unless they are cost-justified. International Chamber of Commerce, *Comments on the Reform of the Application of Article 82 of the EC Treaty*, Document No. 225/623 (12 December 2005) at 15.

ICC has problems understanding why it would be abusive for dominant undertakings to try to 'maintain or strengthen' market shares through the adoption of rebates. . . Competition is generally about increasing market shares to the detriment of competitors. . . [D]ominant undertakings should be allowed to compete aggressively on rebates since this may lead to long-term aggressive price competition. Rebates would become abusive in limited defined circumstances when competitive strategies are not 'on the merits' or involve predatory or other anticompetitive behaviour resulting in likely foreclosure effects, for example, "full line forcing". International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 14-15.

2. What are the likely procompetitive and anticompetitive effects of the conduct in the sort and long term?

Any kind of fidelity rebate can have a pro-competitive role in the sense that it creates further dimension of competition (the non-linear price schedule) and it can represent a more aggressive pricing strategy: hence an additional minimal condition for rebates to be abusive should be that competitors are not able to propose similar rebates or different ones (with different thresholds), . . . International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 16.

3. What types of cost savings, risk reduction or other efficiencies could be generated by such conduct?

[R]ebates increase allocative efficiency and consumer welfare by increasing output and reducing prices. They are often preferred by customers to alternative arrangements and are often the result of hard bargaining by customers to get the best price from undertakings that, because they are dominant, would otherwise charge higher prices. International Chamber of Commerce, *Comments on the Reform of the Application of Article 82 of the EC Treaty*, Document No. 225/623 (12 December 2005) at 13.

Loyalty rebates are particularly important to a pure-play innovation company and ultimately for end-consumers. Consumers may benefit, for example, from a manufacturer having a low marginal input cost, when that low cost is passed on to the consumers. This in turn will provide the manufacturer with an incentive to expand sales by competing on price.

Additionally, loyalty rebates may facilitate efficient recovery of fixed costs. In general, consumers will face higher prices where an innovator needs to charge higher prices – resulting in lower volume – in order to recover fixed research and development costs. A loyalty rebate scheme allows the innovator to charge a relatively high price for the non-contestable share of the market, where demand is relatively inelastic, while charging a lower price (after loyalty rebates) for the contestable part of the market, where demand elasticity is higher. The company can simultaneously profit from a higher margin on the infra-marginal units without losing volume at the margins. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 18.

4. How might competitors respond to counteract a loss of sales to the firm engaging in such conduct, and would that result in harm to consumers?

First, 'distorting' effect on competitors does not necessarily mean 'abusive'. Findings of abuse should be based on a longer-term market assessment that should take into account competitors' likely response to the rebate system, customers' ability to switch and long term benefits for end-users. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 14.

5. What tests and standards should court and enforcement agencies use in assessing whether such conduct violates Section 2?

Increases in allocative efficiency and consumer welfare ought to be regarded as objective justifications for rebates and should negate the assumption that such rebates are exclusionary by their very nature. International Chamber of Commerce, *Comments on the Reform of the Application of Article 82 of the EC Treaty*, Document No. 225/623 (12 December 2005) at 14.

It is critical that the regulation of these practices focus on their effects on the welfare of customers in the market. The ability of rivals to match a dominant firm's discounts is at best ambiguous evidence on the desirability of the practice. Inadequate attention to demonstrable competitive effects could create law that preserves inefficient competitors while sacrificing competition. Remedial relief is not warranted when smaller competitors have difficulty competing against a dominant player that is more efficient. Efficiencies should always be relevant in unilateral conduct cases -- whether proferred in defense of the practice or implicated in the proposed remedy. Challengers of aggressive discounting should bear a heavy burden to show that intervention in the marketplace would produce remedies that benefit consumers without imposing costs that consumers will bear. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 17.

B. Product Tying and Bundling

1. How should the structure of the market and the market shares of participants be taken into account in analyzing such conduct?

Consideration of the effects of a practice should focus on the maintenance or enrichment of market power, not structural dominance. When enforcement agencies or tribunals protect competition through the regulation of single-firm conduct, they must engage in the task of distinguishing between firms that achieve or maintain a dominant position through legitimate means and those that have done so through means that hinder the competitive process. Dominant firms often employ behavior that combines valuable innovation with aggressive marketing. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 17.

2. What are the likely procompetitive and anticompetitive effects of the conduct in the sort and long term?

Market-leading companies should be able to continue producing innovative combinations of products benefiting consumers without running afoul of the prohibitions on tying unless the competition authority can rebut the innovating firm's prima facie case of efficiency gains. When companies combine formerly separate products, consumer welfare is usually increased as firms realize the efficiencies involved. These efficiencies may be the result of greater product functionality or the elimination of double marginalization, or simple convenience. Such tying or bundling may also lead to system-based competition, which may create an even more innovative and competitive market than component-based systems, as the markets for computer systems, home theaters, and cell phones aptly demonstrate. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 23.

3. What types of cost savings, risk reduction or other efficiencies could be generated by such conduct?

[B]undling is a valuable strategy to gain broader distribution of the products or service that is subject to network effects. And the broader the distribution, the greater the value produced for all consumers. This is particularly true when the product or service in question has a low (or no) marginal costs, because the supplier can costlessly include the product or service in bundles with other products. . . Similarly, we believe that it should be acknowledged that bundling can generate efficiencies in multi-sided markets, *i.e.* markets where products or service must be matched with other products or service to have value. . . The complex business models resulting from multi-sided markets often require bundling practices because the consumption on one side of the market is being "sold" on the other side of the market, and piece-meal consumption on one side of the market breaks down the interdependent ecosystem. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 24.

4. Would a business typically analyze or estimate the likely cost savings from this type of conduct before or after engaging in it?

Because the harm over-enforcement can cause to consumer welfare is significant in this area, the ideal test is one that greatly reduces the risk of enforcement by being administrable by competition authorities while being easily and predictably applied by businesses. It would create a safe harbour for which a business can qualify using its own readily available data, thus not diminishing the effects of efficient conduct as a result of compliance costs. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 24-25.

5. How might competitors respond to counteract a loss of sales to the firm engaging in such conduct, and would that result in harm to consumers?

It is critical that the regulation of these practices focus on their effects on the welfare of customers in the market. The ability of rivals to match a dominant firm's discounts is at best ambiguous evidence on the desirability of the practice. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 17.

[T]he fact that other undertakings in the market also offer bundles is a presumption that bundling generates efficiencies and meets consumer demand – if not, bundling by the dominant undertaking would provide competitors with a great opportunity to differentiate their offerings and make them more attractive to consumers. Additionally, the dominant undertaking ought to be able to compete with bundles offered by its competitors. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 22.

If there were sufficient customer demand to make the supply of the unbundled product profitable, competitors of the dominant undertaking would most likely avail themselves of this business opportunity. *Id.*

6. What tests and standards should court and enforcement agencies use in assessing whether such conduct violates Section 2?

[A] safe harbour based upon analysis of whether "the incremental price that customers pay for each of the dominant company's products in the bundle [covers] the long-run incremental costs of the dominant company of including th[e] product in the bundle." Assuming that this safe harbour is sufficient, then for mixed-bundle discounts or rebates that fall outside the safe harbour, the Commission should then continue the analysis by demonstrating (1) a likelihood of recoupment and (2) a likelihood of the creation of substantial market power in the relevant market for the "bundled" product in order to show that discounting through mixed bundling constitutes an abuse of dominance. Absent such a showing, mere exclusion of a competitor should not be found sufficient to establish a finding of anticompetitive bundling. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 23.

The fundamental inquiry when analyzing a tying arrangement should be whether competition is threatened by the practice in question. ICC members believe that this assessment is best accomplished by analyzing tying arrangements under the rule of reason. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 15.

It can be difficult to distinguish between anticompetitive acts and vigorous competition. This is particularly true when the alleged anticompetitive act is the offering of lower prices to customers – practices such as aggressive discounting, attractive rebates, and various loyalty programs. The law should continue to demand that companies challenging such practices demonstrate anticompetitive consequences, because these types of cases may discourage practices that provide significant net benefits. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 16.

Inadequate attention to demonstrable competitive effects could create law that preserves inefficient competitors while sacrificing competition. Remedial relief is not warranted when smaller competitors have difficulty competing against a dominant player that is more efficient. Efficiencies should always be relevant in unilateral conduct cases — whether proferred in defense of the practice or implicated in the proposed remedy. Challengers of aggressive discounting should bear a heavy burden to show that intervention in the marketplace would produce remedies that benefit consumers without imposing costs that consumers will bear. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 17.

[T]he distinct products test itself may not be helpful for understanding market dynamics because, by definition, this test is backward-looking. . . A better approach in these cases would be simply to ask whether the undertaking integrating the previously distinct products can make a plausible showing of efficiency gains. Since technical tying is normally efficient, market-leading undertakings would be able to continue producing innovative products benefiting consumers without running afoul of the prohibitions on tying. *Id.*

We believe that the long-run incremental costs standard is inconsistent with business reality because it requires companies to price bundles to cover sunk fixed costs that are unrecoverable. This approach ignores the economic reality that, when businesses decide how to price a product, they do not consider costs that are "sunk" or "unrecoverable," even if not a single product is sold. . . We believe that a more appropriate cost standard in this case would be marginal costs ("MC") or at least Average Avoidable Costs ("AAC"). When business people decide whether or not to make a marginal sale at a particular price, they generally consider the marginal cost of making that sale. *Id.* at 23.

D. Predatory Pricing

1. How should the structure of the market and the market shares of participants be taken into account in analyzing such conduct?

Dominance itself should not be sufficient to establish the likelihood of recoupment, particularly in technology markets. For example, looking forward one or two years in the dominance inquiry is not sufficient to undertake a proper assessment of recoupment where significant uncertainty abounds regarding not only cost and demand but the existence of potential entrants. It is entirely possible that a firm may be dominant in the sale and/or distribution of a given product, yet be constrained by entrants with highly disruptive technologies which require greater than one or two years to mature and be successfully commercialized. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 13.

2. What tests and standards should court and enforcement agencies use in assessing whether such conduct violates Section 2?

First, pricing at or above average total cost (ATC) should not provide a basis for a claim of predatory pricing. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 21.

Pricing above ATC ["average total cost"] is in general not considered predatory, but according to the virtually unanimous economic literature, it would be better to state explicitly that pricing above ATC is never predatory since it cannot lead to foreclosure of 'as efficient' competitors. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 12.

[T]here are not economic justifications for a change of standard from AVC ["average variable cost] to LAIC ["long-run average incremental cost"]. Moreover, we believe that the LAIC standard is inconsistent with business reality because it requires companies to price to cover average sunk fixed costs that are unrecoverable: this approach ignores the economic reality that, when businesses decide how to price a product, they do not consider costs that are "sunk" or "unrecoverable," even if not a single product is sold. *Id.* at 13.

Recoupment should be a critical element of any predatory pricing claim, since consumers will benefit overall from lower prices unless the firm engaging in below cost pricing is able to recoup all of its losses on a net present value basis. It is therefore not sufficient to presume a "likelihood of recoupment" from the fact that a firm holds a dominant position and, consequently, that there are likely to be barriers to entry into the relevant market. The existence of barriers to entry is necessary for the dominant firm to recoup its losses but is not sufficient to establish that recoupment would occur. The recoupment assessment should take into account the magnitude of the likely losses, the level of increased prices following

foreclosure and the period of time during which those prices would need to be charged, the time value of money, and the prospects for innovation affecting the ability to recoup as well as the prospects for entry prior to recoupment of the losses on a NPV basis. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 21-22.

E. Refusals to Deal

1. How should the structure of the market and the market shares of participants be taken into account in analyzing such conduct?

In a market system of free competition, even a dominant company must, at least in principle, be allowed to freely decide upon its sales strategy and distribution system. If it decides to change its distribution policy, *e.g.*, to terminate existing distribution contracts and to establish a direct sales organization, it is its own choice for which it bears responsibility. Competition law is not meant to guarantee an existing distributor relationship once and for all. As long as the supplier does not act in order to discipline a specific distributor and as long as the necessary termination periods are observed (depending on the given set of facts, the length may vary), there is no reason to intervene. . . Therefore, it should not "fall upon the dominant company to show that consumers are better off with the supply relationship terminated" . . . If there be a presumption at all, it should be in favour of the company's freedom to decide upon its distribution strategy. Only in the case where the terminated dealer can show that he was disciplined or discriminated, the supplier might be required to justify the termination. International Chamber of Commerce, *ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses*, Document No. 225/627 (7 April 2006) at 26.

It is also widely recognized that forcing dominant firms to grant access to their inputs can deter innovation, both by discouraging dominant firms from investing in innovation in the first instance, and by encouraging smaller rivals not to innovate but instead to "free ride" on the innovations of others.[5] The United States Supreme Court, echoing these principles, recently observed that compelling firms who have established an advantage "to share the source of their advantage is in some tension with the underlying purpose of competition law, since it may lessen the incentive for the monopolist, the rival, or both to invest" in ways that promote consumer surplus.[6] United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 25.

It is a well established principle that the rights of intellectual property holders are to be respected in all but most exceptional circumstances. In fact, there is no economic reason why

[5] Brief for the United States, et al, as Amici Curiae Supporting Petitioner, *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No 02-682), 2003 WL 21269559 at *13-20.

[6] Verizon Communs., Inc.,540 U.S. at 407.

cases involving intellectual property rights should be treated any differently than any other case involving a refusal to deal.[7] The purpose of intellectual property law in the first instance is to provide businesses an incentive to invest in research and development activities aimed at generating new products and services. Thus, intellectual property rights are of vital importance to promoting consumer welfare. The adoption of rules and standards that create uncertainty as to when a company may be required to license its intellectual property will have a chilling effect on investment in research and development, to everyone's detriment. This is particularly true in markets that are already subject to governmental regulation. Such regulation tends to significantly reduce the likelihood of major antitrust harm. The additional benefit to competition of adding another layer of legal process will tend to be small, whereas the risk of false positives is high.[8] United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 27.

2. Would a business typically analyze or estimate the likely cost savings from this type of conduct before or after engaging in it?

As in bundling and tying cases, reducing the occurrence of over-enforcement in cases involving refusals to deal while being efficient and administrable requires the consistent application of sound economics. In order not to suppress conduct that would be beneficial to consumers, appropriate standards must be adopted that condemn only conduct that is not "competition on the merits," while allowing firms to reap the fruits of their skill, foresight and industry by being able to predict the likely consequences of their actions. Meaningful guidance must be provided to firms to enable them to know how to avoid liability using data that is readily available to them at the planning stage, and that the conduct, if challenged, will be evaluated under the same efficient standard that applied at the time the company decided to engage in the conduct. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 26.

3. What tests and standards should court and enforcement agencies use in assessing whether such conduct violates Section 2?

The recent decision in *Verizon Communications v. Law Offices of Curtis Trinko, LLP*,[9] deals explicitly with the challenge facing courts in their endeavors to avoid deterring beneficial conduct or imposing remedies that they are ill-equipped to administer. For these reasons the Court declined to use Section 2 to impose upon the defendant a duty to deal with a competitor, even if the refusal allowed the defendant to reap the benefits of its position in the market. . . In essence, the Court reiterated reasons why Section 2 should be applied cautiously to refusals to deal, and resisted the temptation to recognize new theories of liability or to

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7 Illinois Tool Works, 126 S.Ct. at 1293.

8 Verizon Communs., Inc., 540 U.S. at 407-408, 411-15.

9 540 U.S. 398 (2004).

declare the practice immune from attack. ICC members can understand why the Court (and the U.S. competition authorities, which filed briefs in the case) did not regard the situation before it as one of the rare exceptions to the right of parties to choose their customers. Accordingly, we would not characterize the decision as going too far. International Chamber of Commerce, *Comments on Selected Issues for Study by the U.S. Antitrust Modernization Commission*, Document No. 225/621 (1 September 2005) at 14-15.

A firm's dealings with third parties and its prior dealings with rivals provide a baseline for evaluating its challenged conduct. Where a firm is willing to deal with its retail customers on certain terms (such as a certain price), claiming that its refusal to deal with a rival on those terms constitutes anticompetitive conduct makes no economic sense. However, absent discriminatory dealing or departures from prior profitable courses of dealing, decisions by either courts or regulatory agencies to enforce sharing distorts the incentives to innovate and should therefore be avoided. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 26.

ICC believes that patented and non-patented technical technology should be treated on the same footing and that the requirement that the refusal to license prevents the appearance of new goods or services be clearly set out. International Chamber of Commerce, *Comments on the Reform of the Application of Article 82 of the EC Treaty*, Document No. 225/623 (12 December 2005) at 19.

Similarly, there is no justification in law or economics for the proposition that trade secrets should be entitled to less protection under Article 82 than other forms of intellectual property. If trade secrets are provided less protection than other forms of intellectual property, the net effect will be less innovation and competition in the market, not more. This is simply because the protection of trade secrets enables firms to recover the investments they make in the research and development that are necessary for the firm to be able to meet the competitive pressures of its rivals, who are themselves investing in research and development for the same reason. Thus, as is the case with other forms of intellectual property, uncertainty as to the ability to recover the costs of the research and development necessary to create innovative trade secrets acts as a disincentive, to the detriment of consumer welfare. From the other perspective, there is little incentive for risking the loss of your own investment in research and development that may fail to yield the desired results when you have the option of free-riding off of the efforts of a rival. For these reasons, sound economics requires that trade secrets be protected the same as any other form of intellectual property, and that the rules and regulations impacting intellectual property rights not create ambiguity with regards to the extent of their protection. United States Council for International Business, *Submission to the Directorate-General for Competition on the Application of Article 82 of the Treaty to Exclusionary Abuses* (30 March 2006) at 28-29.

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We hope that our comments will be helpful. We welcome the opportunity to expand upon our comments, if necessary.

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