DEPARTMENT OF JUSTICE

North Atlantic Competition Policy: Converging Toward What?

Address by

William J. Kolasky[1]
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Before the

BIICL Second Annual International and Comparative Law Conference
London, England

May 17, 2002

Good morning. It is delightful to be here today, in one of my favorite cities in the world. I made it a point to visit Berkeley Square last night, hoping to hear the nightingales sing.

This address grows out of the discussions we had with the EU last fall over GE/Honeywell,[2] but is not really about GE/Honeywell. What we discovered as we explored the reasons for our different outcomes in that case was that they reflected some deeper differences between competition policy in the United States and in Europe, especially in the area of abuse of dominance and monopolization.

As I began to investigate these differences, I happened to read an article in The Economist entitled *"The Need for Shock Treatment"* reporting on concerns in Europe about a "growth gap" with the United States: in 1991 America's per capita GDP was 42% greater than the EU average; a decade later the gap had widened to 54%.[3] The article attributed this growth gap to the slow pace of market liberalisation in several key sectors of the European economy. The graph I've put up, showing the relationship for OECD member countries between economic growth and an OECD index of market regulation tends to support that thesis. (Figure 1) It shows that countries with less regulation tend to have higher growth rates.

The Economist article started me thinking about whether differences in competition policy may be contributing to the slower growth of the European economy. In the United States, we have gone through a complete reform of our competition policy over the last quarter century. While it is always hard to determine cause-and-effect, this fundamental shift in antitrust policy coincided with the fastest period of economic growth the United States has enjoyed since the period immediately after WWII.

We see Europe going through a similar transition today. I think you all would agree that before 1995 European competition law suffered from many of the same problems under which U.S. antitrust law labored a generation ago. EU competition law relied on wooden, formalistic rules. And, as has sometimes been the case in the United States as well, EU law sometimes placed more emphasis on protecting competitors than consumers, and viewed efficiencies suspiciously.

Under the leadership of Karel Van Miert, Mario Monti, and Alex Schaub the picture has changed dramatically over the last seven years. These three have initiated a series of reforms that will change competition policy in Europe every bit as dramatically as the Chicago School revolution changed it in the United States a generation ago. These include, most notably, the Notice on Vertical Restraints, the Modernization Initiative, the new leniency policy, the Technology Block Exemption Report and, most recently, the Merger Process Reform Green Paper. Alex Schaub, who oversaw the implementation of many of these reforms, will be leaving DG Comp this summer, but he should be very proud of what he has accomplished during his tenure.

As important as these reforms are, none was more significant than Commissioner Monti's firm embrace, at a speech at Merchant Taylor's Hall in London last July, of the consumer welfare approach to competition policy. In that speech Commissioner Monti became the first Competition Commissioner to declare unequivocally that "[T]he goal of competition policy is consumer welfare."[4] Not "a" goal, but "the" goal. We in the United States applaud Commissioner Monti's bold leadership in embracing the consumer welfare model of competition policy.

In the interest of promoting greater convergence, not just in how we talk about competition policy, but in how we practice it, I attempted in a speech I gave in Capetown, South Africa in March to articulate six guiding principles for sound competition policy, which are displayed on my next slide.[5] (Figure 2) I do not propose to cover these in detail today. Instead, I would like to show how these principles might be applied in practice by examining what we see as five areas of historical divergence between US and EU competition policy. The five areas are: efficiencies, fidelity discounts, predatory pricing, essential facilities, and monopoly leveraging.

My purpose in shining a light on these areas is not to try to tell you what your policies should be. We have different legal traditions, different institutions, and different economies. Any sound competition policy must take account of these differences. What works for us is not necessarily best for you. My purpose instead is simply to identify the key issues and to propose that we work together to address them.

I. Efficiencies in Merger Review

In the United States, our Merger Guidelines have included what some refer to as an "efficiencies defense" since the very beginning in 1968. In Europe, by contrast, it was widely believed until very recently that the Commission would not treat efficiencies as a defense to a merger that created or strengthened a dominant position, and that it might even view efficiencies as an additional reason for prohibiting a merger on the ground that they would further entrench the merged firm's dominant position.[6]

In his Merchant Taylor's Hall speech, Commissioner Monti took a critical step toward clarifying the Commission's view of efficiencies. He announced that, "We are not against mergers that create more efficient firms. Such mergers tend to benefit consumers, even if competitors might suffer from increased competition."[7] The director of the EU Merger Task Force, Goetz Drauz, built on these remarks at the ABA Section of Antitrust Law's Spring Meeting last month. He invited merging parties to tell the MTF about the efficiencies they expect to realize from their transactions, assuring them that efficiencies will not be used as a reason to challenge a merger.

Now that the Commission has clarified that efficiencies should be viewed positively, the question is, as Goetz Drauz put it in Washington, "not whether, but how." This is still a lively subject of debate on our side of the Atlantic. There is a widespread perception, for example, that in the United States we apply a so-called "consumer welfare" test, which takes into account only those efficiencies that are likely to be passed on to consumers in the form of lower prices. In Canada, the Competition Tribunal in *Superior Propane* recently rejected this test, opting instead for a "part total welfare, part wealth distribution weighting" test, which it held was mandated by the Canadian statute.[8] Under this test, the Tribunal would approve a merger even if it is likely to result in higher prices, so long as the cost savings exceed what economists call the "deadweight loss" from any reduction in output plus any negative wealth distribution effect on poor consumers.

In practice, our test is less of a pure "consumer welfare" test than is generally thought. While we give greater weight to those efficiencies that will be passed on to consumers through lower prices in the near term, footnote 37 to the Guidelines, which was added as part of the 1997 revisions, makes it clear that we "also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices" where we think those efficiencies will ultimately redound to society's benefit.[9]

The Bell Atlantic-NYNEX merger is a good example of a case where the Division declined to challenge a merger even though a strict price test might have lead to a contrary result. In that case, the Division concluded that while the likely price effects of the efficiencies were small, the efficiencies themselves were so likely and so large and the possible anticompetitive effects so speculative that we should clear the merger nevertheless. Subsequent history has proven the Division right. A retrospective study by one of the merger's critics, AARP, found that the Bell Atlantic/NYNEX merger did, in fact, deliver very substantial cost-savings that surpassed even the parties' projections, as well as a "marked improvement" in service quality.[10]

We have agreed with the European Commission to make this subject a priority of our joint US/EU merger working group. We are very much looking forward to working together in this critical area.

II. Fidelity Rebates

Fidelity rebates are rewards or discounts given to customers who purchase all or a specified portion of their requirements for a given product or service from a dominant firm. In Europe, the Commission and the European Court of Justice have come close to establishing a per se rule against fidelity rebates granted by a dominant firm, the only exceptions being short-term discount programs and volume discounts that are cost-justified and open to all customers on equal terms.[11]

In the United States, by contrast, we tend to view any reduction in price by a leading firm as moving prices toward the competitive ideal so long as the resulting prices are not below cost. We have generally refrained, therefore, from challenging discount programs like these under our antitrust laws.

This difference in approach is illustrated most starkly in the treatment of Virgin Atlantic's complaint about British Airways' incentive system for travel agents, which gave agents extra commissions in return for meeting or exceeding the previous year's sales of BA tickets. The European Commission found BA's incentive program to be an abuse of dominance.[12] By contrast, when Virgin sued BA on the same theory in the United States, the trial court granted summary judgment for BA and that judgment was affirmed on appeal.[13]

This is another area where a transatlantic dialog may be useful. While Europe's per se approach may unnecessarily discourage some procompetitive discounting, there are some in the United States who view the approach of the U.S. courts as too laissez faire.[14] These opposing views are now being litigated in the Third Circuit in *LePage's v. 3-M.*[15] Fidelity rebates will also be the subject of an OECD roundtable next month in Paris. This is clearly an area that will benefit from putting the best minds on both sides of the Atlantic at work together in developing a policy that balances the potential anticompetitive risks against the potential efficiency benefits and thereby promotes consumer welfare and economic progress.

III. Predatory Pricing

The U.S. law on predatory pricing has been reasonably clear at least since the Supreme Court decided the *Brooke Group v. Brown & Williamson* case in 1993.[16] There the Court held that to be found predatory, conduct must satisfy a two-part test: (1) the allegedly predatory price must be below an appropriate measure of cost, and (2) there must be a dangerous probability that the alleged predator will be able to recoup its losses through monopoly prices once its rivals exit the market.

The European Court of Justice has adopted the first leg of the *Brooke Group* test, but has expressly declined to adopt the second leg, holding that recoupment is not a necessary element of predation under Article 82.[17] In addition, whereas most U.S. courts have held that the appropriate measure of cost is average variable cost, the ECJ left open the possibility of finding prices above average variable cost but below average total cost predatory if they are "part of a plan for eliminating a competitor."[18]

We view recoupment as an essential element of the test because, as the Supreme Court has said, "cutting prices in order to increase business often is the very essence of competition."[19] There are many legitimate, procompetitive reasons for charging prices that are below cost, and there is no rational reason to deny consumers the benefits of lower prices in the absence of any realistic prospect for recouping short-term losses through later supracompetitive pricing.

In the United States, we are also chary of relying on subjective intent as a basis for antitrust liability. As Judge Easterbrook has put it very colorfully, we expect firms to want "to crush their rivals if they can."[20] Happily, in finding that Deutsche Post had engaged in predatory pricing in the market for business parcel services last year, the European Commission did not rely on subjective intent but instead adopted an "avoidable" cost standard, which looked only at the incremental or variable costs Deutsche Post incurred in providing these services, rather than at average total cost.[21] That approach is very similar to the approach we have taken in our *American Airlines* predation case, which is now before the Tenth Circuit Court of Appeals.[22]

IV. The Essential Facilities Doctrine

The fourth area in which we see a potentially significant difference between U.S. and EU law relates to the use of the so-called "essential facilities" doctrine to compel access to a dominant firm's facilities. While the essential facilities doctrine originated in the United States, we have construed the doctrine very narrowly, limiting it largely to regulated utilities and joint ventures, out of fear that its overbroad application would both chill incentives to invest and innovate and require antitrust agencies to undertake the uncomfortable task of having to regulate the terms of access.[23]

For this reason, there are no cases in the United States applying the essential facilities doctrine to require the compulsory licensing of intellectual property. Instead, in dealing with antitrust challenges to refusals to license intellectual property, our courts have generally applied what we call the "Colgate" doctrine to hold that refusals to deal are lawful "in the absence of any purpose to create or maintain a monopoly."[24]

This issue is currently a hot topic of debate in the United States due to the seemingly conflicting decisions of the Ninth Circuit Court of Appeals in *ITS v. Kodak*[25] and the Federal

Circuit in *CSU v. Xerox.*[26] Both cases involved the issue of whether a manufacturer of photocopiers could refuse to license its parts to rivals in the aftermarket. The Ninth Circuit held that while a refusal to license was presumptively lawful, it could be challenged if the reasons proffered for the refusal were "pretextual," inviting an inquiry into the defendant's subjective state of mind, which is something we generally try to avoid. The Federal Circuit expressly rejected the Ninth Circuit's approach for just this reason and suggested, in dicta, that a refusal to license should be found unlawful under the antitrust laws only if it were part of a tying arrangement designed to extend the patent monopoly into other fields or if the patent were invalid, a test which some have argued is too restrictive.[27]

A similar debate is ongoing in Europe as a result of two cases, *Magill* and *IMS,* applying, or attempting to apply, the essential facilities doctrine to intellectual property. In *Magill*, the ECJ ordered television stations in Ireland to license their program listings to a competitor seeking to create a single guide for all channels.[28] In *IMS*, the Commission concluded preliminarily that IMS had abused its dominant position by refusing to license to its competitors in Germany its copyrighted "brick structure" — a system for dividing the country into geographic units for collecting data on pharmaceutical sales.[29] On appeal, the Court of First Instance (CFI) suspended the Commission's interim decision. Supporters of the application of the essential facilities doctrine in these cases have argued that they both involved "extraordinary circumstances" in that the copyrights in question did not involve the kind of creativity copyright law is designed to encourage and that the decisions therefore should not undercut the incentive to invest and innovate. This raises the prospect of basing competition policy on whether we think the intellectual property rights at issue are worth protecting; this kind of ex post judgment cannot help but create uncertainty and reduce the incentive to innovate.

This is another area where we and the EU are both currently reexamining our existing policies. The Federal Trade Commission and we are holding a series of hearings on intellectual property and antitrust. On May 22, we will be having a session to take a comparative look at how these issues are handled in the United States and Europe and will have EU officials and European lawyers participating. In addition, we are considering forming a joint US/EU IP working group, similar to our joint merger working group, to coordinate our parallel reviews of our policies toward intellectual property more closely.

IV. Monopoly Leveraging

The final area of divergence is what we call monopoly leveraging in the United States — that is, using a dominant position in one market to gain a competitive advantage in another. Most U.S. courts have held that it is not unlawful for a firm with a monopoly in one market to use its monopoly power in that market to gain a competitive advantage in neighboring markets, unless by so doing it serves either to maintain its existing monopoly or to create a dangerous probability of gaining a monopoly in the adjacent market as well.[30] My understanding is that under EU law, by contrast, it is an abuse of dominance for a firm that is dominant in one market to use that position to gain a competitive advantage in a neighboring market in which it is not dominant even if the conduct is not shown to be likely to create a dominant position in the second market unless the dominant firm can show a legitimate business justification for its conduct.[31]

Our view, by contrast, is that, "so long as we allow a firm to compete in several markets, we must expect it to seek the competitive advantages of its broad-based activity — more efficient production, greater ability to develop complementary products, reduced transactions costs, and so forth,"[32] and that allowing it to do so ultimately benefits consumers. Again, this is an area that would benefit from a constructive transatlantic dialog over our differing approaches.

Conclusion

This has been a pretty exhaustive — and exhausting — tour of the areas in which we currently see potentially significant differences between our competition policies in the United States and your's here in Europe. My purpose in identifying these is to open up a more in-depth transatlantic dialogue, both to determine how real these differences are and to begin discussing whether and how we should try to bridge them. And that brings me back to the title of my paper. While there is value in convergence, convergence should not become an end in itself. Our goal is not convergence for its own sake, but rather convergence around sound competition policies. I hope we can all agree that sound competition policies should generally be those that best promote efficiency, economic growth, and consumer welfare. I also hope that we can reach agreement that in pursuing these goals our competition policies should embody the guiding principles we laid out in Capetown.

Again, I want to emphasize that we are not trying to dictate to anyone what the best approach to these difficult issues is. Given the differences in our economies, our legal traditions and systems, and our institutions, what works best for us may not be best for Europe. What I hope, however, is that we can at least agree on what our goals are and on what principles we should apply in developing administable legal rules. I would hope we could also agree to work together in designing the best possible rules for our economies in these very difficult areas where we are both still struggling to get it right..

The silver lining to the GE/Honeywell cloud is that it has opened up a much more substantive dialog between Washington and Brussels, and I believe within Europe, over these important issues. I hope this talk contributes in some small way to moving that dialog forward.

1. Deputy Assistant Attorney General for International Enforcement, Antitrust Division, U.S. Department of Justice. These remarks reflect my personal views and not necessarily those of the Department. I want to thank the many people who contributed importantly to this paper, including Nancy Garrison, Caldwell Harrop, Greg Werden, Robert Nicholson, John Fonte, Michael Klass, Christina Akers, and, of course, my assistant, Gloria Jenkins. I also want to thank Barry Hawk, Eleanor Fox, Douglas Melamed and Michael Katz who provided useful comments on earlier drafts. Any mistakes found in this speech are, of course, my own.

2. General Electric/Honeywell, Case No.M.2220, Commission decision of July 3, 2001.

3. *The Need for Shock Treatment- the EU Barcelona Summit*, Economist, Mar. 9, 2002, at 52.

4. Mario Monti, *The Future for Competition Policy in the European Union,* Address at Merchant Taylor's Hall, London (July 9, 2001).

5. William J. Kolasky, *Comparative Merger control Analysis: Six Guiding Principles for Antitrust Agencies — News and Old*, Address to the International Bar Association Conference on competition Law and Policy in a Global Context, Cape Town, South Africa (Mar. 18, 2002)(available at usdoj.gov/atr/public/speeches/10845.htm).

6. Frederick Jenny, *Competition and Efficiency, in* Antitrust in a Global Economy, 1993 Corporate Law Institute, Fordham U. School of Law, 194 (B. Hawk, ed., 1994).

7. Mario Monti, *supra* n.4.

8. Commissioner of Competition v. Superior Propane, Inc., CT-98/02 (Competition Tribunal, April 4, 2002) (Reasons and Order Following the Reasons for Judgment of the Federal Court of Appeal Dated April 4, 2001), available at: http://www.ct-tc.gc.ca/english/cases/propane/0238a.pdf

9. U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines § 4, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1992, rev'd 1997), sec. 4.

10. Scott C. Lundquist and Scott A. Coleman, *Promises and Realities: An Examination of the Post-Merger Performance of the SBC/PACIFIC Telesis and Bell Atlantic/NYNEX Companies*, AARP Public Policy Institute, 9 (1999).

11. Carles Esteva Mosso and Stephen Ryan, *Article 82- Abuse of a Dominant Position,* The EC Law of Competition (Jonathan Faull & Ali Nikpay, eds., 1999), 178.

12. Virgin/British Airways, Case No. IV/D-2/34.780, Commission decision of July 14, 1999.

13. Virgin Atlantic Airways LTD v. British Airways PLC, 257 F.3d 256, (2d Cir. 2001).

14. *See* Willard K. Tom, David A. Balto, & Neil W. Averitt, *Antocompetitiv4 Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 Antitrust L. J. 615 (2000). *See als* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal — Why Aspen and Kadak Are Misguided*, 68 Antitrust L. J. 659 (2001).

15. LePage's, Inc. v. 3M, 277 F.3d 365 (3rd Cir. 2002).

16. Brooke Group LDT v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (U.S.N.C. 1993).

17. *See* Tetra Pak Rausing SA v. Comm'n, Case C-333/94P, [1996] ECR I-5951 (1996).

18. AKZO Chemie BV v. Comm'n, Case C-62/86, [1991] ECR I-3359 (1991).

19. *Brooke Group*, 509 U.S. at 226.

20. A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1401 (7th Cir. 1989).

21. United Parcel Service/Deutsche Post AG, Case No. COMP/35.141, Commission decision of March 20, 2001.

22. U.S. v. AMR Corp., 140 F.Supp.2d 1141, (D.Kan Apr 27, 2001).

23. Gregory J. Werden, *The Law and Economics of the Essential Facility Doctrine*, 32 Saint Louis University Law Journal 433-479 (1987). *See also* Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L. J. 841 (1989).

24. U.S. v. Colgate & Co., 250 U.S. 300, (1919).

25. Image Technical Services, Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997).

26. CSU LLC v. Xerox Corp., 531 U.S. 1143 (2001).

27. A. Douglas Melamed and Ali M. Stoeppelwerth, *The CSU Case: Facts, Formalism and the Intersection of Antitrust and Intellectual Property Law*, 10 Geo. Mason L. Rev. (forthcoming 2002). *See also* R. Hewitt Pate, *Refusals to Deal and Intellectual Property Rights*, Geo. Mason L. Rev. (forthcoming 2002).

28. Radio Telefix Eireann/Independent Television Publications Ltd., Case No. C-241/91 P and C-242/91 P, Commission decision on April 6, 1995.

29. National Data Corporation/IMS Global Services, Case No. COMP/38.044, Commission decision on July 3, 2001.

30. *See* ABA Section of Antitrust Law, I Antitrust Developments 282-85 (4th ed. 1997).

31. *See, e.g.*, Tetra Pack Rausing SA v. Comm'n, C-333/94P, [1996] ECR I-5951 (1996).

32. Berkey Photo v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979).