

**COMMENT OF THE GLOBAL ANTITRUST INSTITUTE,  
ANTONIN SCALIA LAW SCHOOL, GEORGE MASON UNIVERSITY,  
ON THE JAPAN FAIR TRADE COMMISSION’S DRAFT GUIDELINES  
CONCERNING DISTRIBUTION SYSTEMS AND BUSINESS  
PRACTICES UNDER THE ANTIMONOPOLY ACT**

May 4, 2017

This comment is submitted in response to the Japan Fair Trade Commission’s (JFTC’s) consultation on its Draft Guidelines Concerning Distribution Systems and Business Practices Under the Antimonopoly Act. We appreciate the opportunity to comment and commend the JFTC for its transparency. We submit this comment based upon our extensive experience and expertise in antitrust law and economics.<sup>1</sup>

**INTRODUCTION**

Overall, we commend the JFTC for recognizing that vertical restraints may have either pro- or anticompetitive effects, but we have four principle concerns with the Draft Guidelines.

First, though the Draft Guidelines appear to apply a “rule of reason” or effects-based approach to most vertical restraints, Part I.3 and Part I, Chapter 1 carve out resale price maintenance (RPM) practices on the ground that they “usually have significant anticompetitive effects and, as a general rule, they tend to impede fair competition.” Given the economic theory and empirical evidence showing that vertical restraints, including RPM, rarely harm competition and often benefit consumers,<sup>2</sup> we strongly urge the JFTC to reconsider its approach. For the

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<sup>1</sup> The Global Antitrust Institute (GAI), a division of the Antonin Scalia Law School at George Mason University (Scalia Law), is a leading international platform for economic education and research that focuses upon the legal and economic analysis of key antitrust issues confronting competition agencies and courts around the world. University Professor Joshua D. Wright, Ph.D. (economics), is the Executive Director of the GAI and a former U.S. Federal Trade Commissioner. Koren W. Wong-Ervin is the Director of the GAI, and Adjunct Professor at Scalia Law, and former Counsel for Intellectual Property and International Antitrust at the U.S. Federal Trade Commission. Professor of Law Douglas H. Ginsburg is a Senior Judge, United States Court of Appeals for the District of Columbia Circuit, Chairman of the GAI’s International Board of Advisors, and a former Assistant Attorney General in charge of the Antitrust Division of the U.S. Department of Justice. Associate Dean for Research and Faculty Development and Professor of Law Bruce H. Kobayashi, Ph.D. (economics), is a GAI Senior Scholar and Founding Director.

<sup>2</sup> See, e.g., James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT’L J. INDUS. ORG. 639, 642, 658 (2005) (surveying the empirical literature, concluding that although “some studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition,” and, “in most of the empirical studies reviewed, vertical practices are found to have significant pro-competitive effects”); Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding*, 76 ANTITRUST L.J. 431 (2009); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005); Daniel P. O’Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility*

reasons set forth in Section II, we recommend that the JFTC apply a rule of reason or effects-based analysis to all vertical restraints, including RPM, under which restraints are condemned only if any anticompetitive harm they cause outweighs any procompetitive benefits they create.

Second, the Draft Guidelines identify two types of effects of vertical non-price restraints, “foreclosures effects” and “price maintenance effects.” We urge the JFTC to require proof of actual anticompetitive effects for both competition and unfair trade practice violations, just as it requires proof of procompetitive effects. We also recommend that the agency take cognizance only of *substantial* foreclosure effects, that is, “foreclosure of a sufficient share of distribution so that a manufacturer’s rivals are forced to operate at a significant cost disadvantage for a significant period of time.”<sup>3</sup> “A consensus has emerged that a necessary condition for anticompetitive harm arising from allegedly exclusionary agreements is that the contracts foreclose rivals from a share of distribution sufficient to achieve minimum efficient scale.”<sup>4</sup> “[T]he critical market share foreclosure rate should depend upon the minimum efficient scale of production. Unless there are very large economies of scale in manufacturing, the minimum foreclosure of distribution necessary for an anticompetitive effect in most cases would be substantially greater than 40 percent. Therefore, 40 percent should be thought of as a useful screening device or ‘safe harbor,’ not an indication that anticompetitive effects are likely to exist above this level.”<sup>5</sup>

We also strongly urge the JFTC to include an analysis of the counterfactual world, i.e., to identify “the difference between the percentage share of distribution foreclosed by the allegedly exclusionary agreements or conduct and the share of distribution in the absence of such an agreement.”<sup>6</sup> Such an approach to assessing foreclosure isolates any true competitive effect of the allegedly exclusionary agreement from other factors.

We also recommend the JFTC explicitly recognize that evidence of new or expanded entry during the period of the alleged abuse can be a strong indication that the restraint at issue did not foreclose competition or have an anticompetitive effect.<sup>7</sup> With respect to price increases,

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*Theorems*, in THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 72–76 (2008) (“[W]ith few exceptions, the literature does not support the view that [vertical restraints] are used for anticompetitive reasons” and “[vertical restraints] are unlikely to be anti-competitive in most cases.”).

<sup>3</sup> Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits”*, 12 GEO. MASON L. REV. 119, 122–28 (2003).

<sup>4</sup> Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1166 (2012) (collecting sources). See also Derek W. Moore & Joshua D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 GEO. MASON L. REV. 1205 (2015).

<sup>5</sup> Klein, *supra* note 3, at 126.

<sup>6</sup> Wright, *supra* note 4, at 1165.

<sup>7</sup> See INT’L COMPETITION NETWORK, UNILATERAL CONDUCT WORKING GROUP, UNILATERAL CONDUCT WORKBOOK, CH. 6: TYING AND BUNDLING ¶¶ 104–05 (Apr. 2015), <http://www.internationalcompetitionnetwork.org/uploads/2014-15/icn%20unilateral%20conduct%20workbook%20-%20chapter%206%20tying%20and%20bundling.pdf>.

it is important to recognize and consider other factors, including changes in the product and changes in demand, that may explain higher prices.<sup>8</sup>

Third, Part II, Chapter 3 would impose unfair trade practice liability for unilateral refusals to deal that “tend to make it difficult for the refused competitor to carry on normal business activities.” We strongly urge the JFTC to reconsider this approach for the following reasons.

First, the proposed standard (“tend to make it difficult”) is vague and unclear.

Second, although a firm’s competitors may want to use a particular good or technology in their own products, there are few situations, if any, in which access to a particular good is necessary to compete in a market. Indeed, one of the main reasons not to impose liability for unilateral, unconditional refusals to deal is “pragmatic in nature and concerns the limited abilities of competition authorities and courts to decide whether a facility is truly non-replicable or merely a competitive advantage.”<sup>9</sup> For one thing, there are “no reliable economic or evidential techniques for testing whether a facility can be duplicated,” and it is often “difficult to distinguish situations in which customers simply have a strong preference for one facility from situations in which objective considerations render their choice unavoidable.”<sup>10</sup>

In addition, forced competition based on several firms using the same inputs may actually preserve monopolies by removing the requesting party’s incentive to develop its own inputs. Consumer welfare is not enhanced only by price competition; it may be significantly improved by the development of new products for which there is an unsatisfied demand. If all competitors share the same facilities this will occur much less quickly if at all. In addition, if competitors can anticipate that they will be allowed to share the same facilities and technologies, the incentives to develop new products is diminished. Also, sharing of a monopoly among several competitors does not in itself increase competition unless it leads to improvements in price and output, i.e., nothing is achieved in terms of enhancing consumer welfare. Competition would be improved only if the terms upon which access is offered allow the requesting party to effectively compete with the dominant firm on the relevant downstream market. This raises the issue of whether the dominant firm is entitled to charge a monopoly rate or whether, in addition to granting access, there is a duty to offer terms that allow efficient rivals to make a profit.<sup>11</sup>

Lastly, the Draft Guidelines refer throughout to the goal of promoting “fair and free competition.” Part I.3 in particular provides that “[i]f a vertical restraint tends to impeded fair competition, such restraint is prohibited as an unfair trade practice.” For competition policy regimes that have adopted a welfare and effects-based approach to antitrust law, but also enforce a prohibition against unfair trade practices, the dual enforcement mandate can potentially create a

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<sup>8</sup> *Id.* ¶¶ 107–08.

<sup>9</sup> ROBERT O’DONOGHUE & JORGE PADILLA, *THE LAW AND ECONOMICS OF ARTICLE 102 TFEU* 518–19 (2d ed. 2013).

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

significant tension if not outright conflict between the two regimes. Economically sound competition policy is grounded firmly in the notion that its application does not regulate ex post outcomes between firms—that is, competition policy should not pick winners and losers in the marketplace—but rather, should govern the competitive process. However, laws prohibiting unfair trade practices can be interpreted as barring some vigorous competitive conduct that makes consumers better off but has a burdensome effect on a rival.

Modern competition regimes committed to an economic approach to antitrust that are also charged with enforcing a law against unfair methods of competition are thus faced with a difficult question: How can they interpret the prohibition of unfair methods of competition and remain faithful to the economic approach underlying enforcement of their antitrust regime? From an economic perspective, there is no generally accepted definition of “unfairness.” However, one can derive two general and competing views of the proper relationship between unfairness and competition law.

The first contemplates unfairness liability as a complement to antitrust enforcement. Unfairness liability under this view is designed to reach business conduct that generates the same types of effects—the anticompetitive acquisition or creation of market power—as business conduct that would otherwise violate the antitrust laws. Unfairness liability under this view might usefully protect consumers by filling gaps in the competition law, but would not undermine the objectives of competition law.

The second view contemplates competition law and unfairness as substitutes. Under this second view, unfairness liability is entirely untethered from competition policy principles. This view of unfairness liability condemns aggressive practices that are procompetitive, and thus undermines the objectives of an effects-based competition law regime. The 100-year history of the U.S. Federal Trade Commission (FTC) and its application of the ban on unfair methods of competition pursuant to Section 5 of the FTC Act is indicative of the notion that unfairness untethered from competition law principles is likely to lead to bad outcomes for consumers.<sup>12</sup>

Economic theory can illuminate the tradeoffs facing competition regimes choosing between these two competing views. The first view interprets “unfairness” from an ex ante perspective—that is, the relevant question is whether firms have been afforded an opportunity to compete. The second view interprets unfairness from an ex post perspective—that is, the relevant question is whether the outcome of the competitive process disadvantages one or more firms.

Evaluating unfairness from an ex ante perspective can be consistent with an economic

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<sup>12</sup> See generally William E. Kovacic & Marc Winerman, *Competition Policy and the Application of Section 5 of the Federal Trade Commission Act*, 76 ANTITRUST L.J. 929, 940–41 (2010) (“The FTC’s record of appellate litigation involving applications of Section 5 that go beyond prevailing interpretations of the other antitrust laws is uninspiring.”); Joshua D. Wright, Comm’r, FED. TRADE COMM’N, *What’s Your Agenda?*, Remarks at the ABA Antitrust Spring Meeting 7 (Apr. 11, 2013), [http://www.ftc.gov/sites/default/files/documents/public\\_statements/whats-your-agenda/130411abaspringmtg.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/whats-your-agenda/130411abaspringmtg.pdf) (“[I]t is no surprise [that Kovacic & Winerman] conclude the ‘FTC experience with Section 5 is generally a bleak record.’”).

approach to antitrust. Indeed, it can overlap entirely from an economic perspective because the relevant inquiry is focused on whether there was an opportunity to compete. The competitive process is evaluated rather than outcomes for individual competitors. Ex ante fairness can be determined by considering such things as whether there are barriers to entry in the relevant market, or whether rivals were anticompetitively excluded from the *opportunity to compete* for distribution. This approach to unfairness is consistent with the effects-based approach of traditional competition laws. While this interpretation of unfairness overlaps considerably with the competition laws in any country—it does not eliminate the role of unfairness analysis to reach conduct that anticompetitively creates market power but is not otherwise reached by antitrust laws.

Alternatively, fairness can be evaluated only by examining the result of competition in the market and observing whether outcomes were fair from an ex post perspective. Economists have long understood that market outcomes that appear to be “unfair” or one-sided are often efficient. Evaluating unfairness ex post undoubtedly will create tension with an antitrust law the goal of which is to maximize consumer welfare and promote competition generally. Ex post unfairness allows competition tools to govern outcomes of bargaining disputes, prices themselves, or other conduct unlikely to harm competition. For example, leveraging bargaining power and engaging in price discrimination both have the potential to increase consumer welfare but would often seem to violate an ex post fairness standard. Further, regulating conduct that is unlikely to harm competition can chill procompetitive conduct, such as innovation, that benefits consumers.

The United States experience is a useful example to illustrate the pitfalls of an ex post approach to unfairness. For nearly 100 years, the U.S. FTC operated without a consistent definition of “unfair methods of competition” and liability was often based upon ex post unfairness. During that time, the FTC’s application of its unfair methods of competition authority is now understood to have punished much procompetitive conduct and been applied in a manner inconsistent with the goals of the antitrust laws.<sup>13</sup> In 2015, more than a century into its existence, the FTC corrected this approach by linking unfairness explicitly to the concept of harm to competition as understood under the traditional U.S. antitrust laws. The 2015 FTC Unfair Methods of Competition Statement embraced only ex ante unfairness and tethered that notion to the economic principles underlying sound antitrust policy.<sup>14</sup> The policy statement made clear that the FTC will be guided by three principles when enforcing Section 5’s “unfair method of competition” provision: (1) promote consumer welfare as that term is generally understood in U.S. antitrust law precedent; (2) evaluate conduct by balancing harm to competition or the competitive process against the procompetitive benefits of that conduct; and (3) do not apply Section 5 to the conduct if the U.S. antitrust laws (the Sherman or Clayton Act) are sufficient to address the competitive concern at issue.

Tying unfairness to antitrust principles ensures the alignment of unfairness with the

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<sup>13</sup> See Kovacic & Winerman, *supra* note 12, at 940-43; Wright, *supra* note 12, at 6–7.

<sup>14</sup> FED. TRADE COMM’N, Statement of Enforcement Principles Regarding “Unfair Methods of Competition” Under Section 5 of the FTC Act (Aug. 13, 2015), [https://www.ftc.gov/system/files/documents/public\\_statements/735201/150813section5enforcement.pdf](https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf).

economic principles underlying competition laws. Enforcement of unfair methods of competition statutes should focus on harm to competition, while taking into account possible efficiencies and business justifications. For example, invitations to form a cartel fall outside the scope of the U.S. antitrust laws but are condemned as an unfair method of competition because of the threat they pose to consumer welfare. While unfairness can be a useful tool in reaching conduct that harms competition but is not within the scope of the antitrust laws, it is imperative that unfairness be linked to the fundamental goals of the antitrust laws.

## **SPECIFIC RECOMMENDATIONS ON INDIVIDUAL PROVISIONS**

### **I. Part I.3 on Multi-Sided Platforms**

We commend the JFTC for recognizing that standard antitrust analysis applies to conduct by multi-sided platforms. However, we strongly urge the agency to avoid any presumption that network effects create either market power or barriers to entry, and instead recommend a fact-specific case-by-case analysis with empirical backing on the presence and effect of any network effects.

Network effects occur when the value of a good or service increases as the number of people who use it grows. Network effects are generally beneficial.<sup>15</sup> While there is some dispute over whether and under what conditions they might also raise exclusionary concerns, “transactions involving complementary products (indirect network effects) fully internalize the benefits of consuming complementary goods and do not present an exclusionary concern.”<sup>16</sup> “As in all analysis of network effects, the standard assumption that quantity alone determines the strength of the effect is likely mistaken.”<sup>17</sup> Rather, to the extent that advertisers, for example, care about end users, they care about many of their characteristics. An increase in the number of users who are looking only for information and never to purchase goods may be of little value to advertisers.<sup>18</sup> “Assessing network or scale effects is extremely difficult in search engine advertising [for example], and scale may not even correlate with increased value over some ranges of size.”<sup>19</sup>

To understand the appropriate analysis for antitrust matters involving multi-sided platforms, it is essential to understand the complexities and interdependencies involved. An important economic characteristic is that even relatively small changes can hinder the efficient

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<sup>15</sup> See, e.g., Geoffrey A. Manne & Joshua D. Wright, *Google and the Limits of Antitrust: The Case Against the Antitrust Case Against Google*, 34 HARV. J. LAW & PUB. POL’Y 172, 208 (2011).

<sup>16</sup> *Id.* (citing Stan J. Liebowitz & Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, 8 J. ECON. PERSP. 133, 135 (1994); Daniel F. Spulber, *Unlocking Technology: Antitrust and Innovation*, 4 J. COMP. L. & ECON. 915 (2008)).

<sup>17</sup> Manne & Wright, *supra* note 15 at 208.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

operation of platforms and negatively affect innovation.<sup>20</sup> Although there is no canonical definition of a platform, Jean-Charles Rochet and Nobelist Jean Tirole explain that “a market is two-sided if the platform can affect the volume of transactions by charging more to one side of the market and reducing the price paid by the other side by an equal amount; in other words, the price structure matters, and platforms must design it so as to bring both sides on board.”<sup>21</sup>

A defining feature of platforms is the interrelationship among various groups—e.g., suppliers and customers—with each other and with the platform.<sup>22</sup> These relationships and interactions often result in platform-specific investments.<sup>23</sup> The same interdependencies also prompt platforms to balance the needs of the various groups when making pricing and design decisions. For example, Spotify’s free version (which includes advertisements) offers millions of digital songs and a variety of features in order to attract users, who, in turn, attract advertisers. Spotify’s business decisions must balance the preferences of these two groups. More ads increase short-run revenue but likely decrease the value of the service to users. Fewer ads increase the value for users but may lower the value of the platform to advertisers. A more attractive design and higher quality streaming increase the quality of the platform to both users and advertisers.

The relationships of various groups to the platform and to each other can create pricing incentives that differ markedly from nonplatform markets. For instance, profit-maximization may involve charging one group less than the marginal cost to serve that group, e.g., by giving them free access or even a subsidy to participate.<sup>24</sup> For example, Spotify’s basic version is offered free of charge to end-user consumers despite the fact that it is costly to operate. Yet, free access is perfectly consistent with the incentives of the platform because if Spotify were to charge all users to access the platform, then there would be fewer users, which would mean fewer advertisers. With fewer advertisers, the platform’s revenues would fall. Therefore, it is reasonable to infer that the revenue gain from charging for access would not compensate for the loss from lower ad revenue.<sup>25</sup>

Similarly, when a platform implements a design change, it affects demand *across the entire platform*.<sup>26</sup> Suppose a platform introduces a design feature—for example, fingerprint

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<sup>20</sup> Joshua D. Wright & John Yun, *Stop Chug-a-lug-a-lugin 5 Miles an Hour on Your International Harvester: How Modern Economics Brings the FTC’s Unfairness Analysis Up to Speed with Digital Platforms*, 83 GEO. WASH. L. REV. 2130, 2135 (2015).

<sup>21</sup> Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. ECON. 645, 664–65 (2006).

<sup>22</sup> Andrei Hagiu & Julia Wright, *Multi-sided Platforms 5* (Harvard Bus. Sch., Working Paper No. 15-037, 2015), [http://www.hbs.edu/faculty/Publication%20Files/15-037\\_cb5afe51-6150-4be9-ace2-39c6a8ace6d4.pdf](http://www.hbs.edu/faculty/Publication%20Files/15-037_cb5afe51-6150-4be9-ace2-39c6a8ace6d4.pdf).

<sup>23</sup> *See id.*

<sup>24</sup> *See* David S. Evans & Michael Noel, *Defining Antitrust Markets When Firms Operate Two-Sided Platforms*, 2005 COLUM. BUS. L. REV. 667, 668, 681–82 (2005).

<sup>25</sup> *See id.* at 675–76 (describing “advertising-supported media”).

<sup>26</sup> *See id.* at 669.

technology to “verify” purchases—that reduces overall transaction costs. The design change makes the platform company better off while also increasing consumer welfare through improving the user experience and increasing market output through greater app purchases. One fundamental insight from basic platform economics—and in particular, interdependent demand—is that consumer welfare depends upon aggregating effects across different sides of the platform. The critical point is that, when a product design change is made, the benefits and costs of the change are felt throughout the entire platform.<sup>27</sup> Focusing on only a certain segment of the platform, e.g., disregarding the inherent complementarity between Apple’s hardware sales and its operating system design, ignores the various relationships, how the platform monetizes its services, and how these interactions ultimately affect consumers.

In contrast, firms making pricing and design decisions in nonplatform markets generally need not consider differential effects of those decisions on various market participants.<sup>28</sup> Below-cost pricing of a tractor, for example, cannot be offset through increased participation from the tractor’s input suppliers, as this idea is effectively meaningless in a nonplatform setting. Thus, when a tractor manufacturer makes pricing or product design decisions, including disclosure decisions, it bases those decisions solely upon its own input costs and the direct effect on its consumers.

The economics of platforms and multi-sided markets implies that application of many of the standard antitrust principles applied in the nonplatform setting are likely to lead to perverse results. Indeed, “[t]he economics literature that has developed since 2000 shows robustly that many results derived from models of one-sided businesses generally do not apply to multi-sided platforms that serve different interdependent customer groups.”<sup>29</sup>

For example, the existence of demand interdependencies in multi-sided platforms affects commonly used approaches to assessing market power.<sup>30</sup> It is worth noting that there has been a movement by the United States competition agencies away from focusing upon market definition and market power to infer competitive effects. In particular, the agencies increasingly have shifted their focus to a direct assessment of incentives and competitive effects, as evidenced by the 2010 Horizontal Merger Guidelines, and away from using market shares to predict whether a firm have market power or is likely to increase prices. This is no different for multi-sided markets. However, multi-sided platforms do raise additional issues. As David Evans and Richard Schmalensee explain:

[I]t is not always clear how to compute “share” for multi-sided firms. Consider a software platform. One of the main “products” that software developers get from the platform is access to users; one of the main “products” that users get is the

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<sup>27</sup> See *id.* at 684.

<sup>28</sup> See *id.* at 668.

<sup>29</sup> See, e.g., David S. Evans & Richard Schmalensee, *The Antitrust Analysis of Multi-Sided Platform Businesses* 4 (Chicago Inst. for L. & Econ., Working Paper No. 623, 2013), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2185373](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2185373) (surveying the economic literature).

<sup>30</sup> See, e.g., *id.* at 19–20.



access to software developers. One could compare shares for each of these sides across platforms and then make a judgment about market power based on looking at the shares for both sides, but there is no reason to expect those shares to be equal.<sup>31</sup>

In addition, multi-sided platforms often provide one of their products free of charge or at a subsidized price, which would make it impossible to calculate a value-based market share, as is ordinarily recommended, since the price does not reflect the value received by the user.<sup>32</sup>

Several authors have warned against basing judgments about market power on analysis of only a single side of a multi-sided platform.<sup>33</sup> It is empirically common for platforms to have prices that are significantly above marginal cost on one side and at or below marginal cost on the other side.<sup>34</sup> A platform could have a monopoly in which it earns significantly more than a competitive rate of return yet price at or below marginal cost on the other side of the platform. Examining price on that side alone would result in a false negative test result for market power. Conversely, a platform could earn only a competitive rate of return even while pricing significantly above marginal cost on one side. Examining price on that side alone would result in a false positive test result for market power.<sup>35</sup>

Another example involves market definition, namely the consequences of applying analytical tools that were developed for single-sided firms to defining a product offered on one side of a multi-sided platform. For instance, David Evans and Michael Noel demonstrated that the failure to consider positive feedback effects in demand can result in significantly overstating or understating the breadth of the market, depending on the analytical approach.<sup>36</sup>

Consider the case of a merger between two symmetric MSPs [multi-sided platforms] that serve the same customer groups A and B. To define the market an analyst proceeds by starting with the merger of the products that serve demand for, say, side A because that is the focus of the competition concern. The set of

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<sup>31</sup> *Id.* at 20.

<sup>32</sup> *Id.*

<sup>33</sup> Elena Argentesi & Lapo Filistrucchi, *Estimating Market Power in a Two-Sided Market: The Case of Newspapers*, 22 J. APPL. ECON. 1247 (2007); David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 YALE J. ON REG. 325 (2003); Minjae Song, *Estimating Platform Market Power in Two-Sided Markets with an Application to Magazine Advertising*, (Simon Sch. of Bus. Admin., Univ. of Rochester, Working Paper No. FR 11-22, 2013), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1908621](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1908621); E. Glen Weyl, *A Price Theory of Multi-Sided Platforms*, 100 AM. ECON. R. 1642 (2010); Julian Wright, *One-Sided Logic in Two-Sided Markets*, 3 REV. NETWORK ECON. 44 (2004).

<sup>34</sup> Evans & Schmalensee, *supra* note 29, at 20.

<sup>35</sup> *Id.*

<sup>36</sup> David S. Evans & Michael D. Noel, *The Analysis of Mergers that Involve Multisided Platform Businesses*, 4 J. COMP. L. & ECON. 663 (2008) [hereinafter Evans & Noel, *The Analysis of Mergers that Involve Multisided Platform Businesses*]; David S. Evans & Michael D. Noel, *Defining Antitrust Markets When Firms Operate Two-Sided Platforms*, 3 COLUM. BUS. L. REV. 101 (2005).

products is expanded until a hypothetical monopolist over that set of products could raise price by, say, five percent or more on each of those products. That set of products then defines the market for analysis.

However, by ignoring side B the analyst fails to consider that the hypothetical price increase reduces the number of side A customers available to side B, which thereby reduces the prices that side B customers will pay, and furthermore reduces the number of side B customers available to side A, which in turn reduces the prices that side A customers will pay. The link between sides A and B reduces the profitability of any price increase. Therefore, the market would be drawn too narrowly and estimates of market concentration too high, because the standard approach fails to consider the tempering effects on price coming from the other side. However, we will also show that the use of common one-sided calibration techniques to obtain elasticity estimates which could not otherwise be directly estimated can cause a reverse bias instead, with the market drawn too broadly. So the overall bias will depend on the nature of the MSPs and the estimation technique used.

The mistake though is more profound. . . . Failure to consider those multi-sided relationships can result in Type I and Type II errors.<sup>37</sup>

Other examples involve exclusionary conduct. Economists have developed a variety of analytical tools and models to help analyze whether particular business practices are likely to harm consumers, and the results of these analytical tools and models change when the assumptions used change.<sup>38</sup> With respect to exclusionary conduct in particular, most of the theoretical models used in antitrust analysis assume, explicitly or implicitly, that the businesses considered are single-sided. A relatively small number of authors have extended some of these models to multi-sided platform context. David Evans & Richard Schmalensee surveyed this work and found that, overall, the work to date shows “that one-sided results generally do not apply to multi-sided firms,” and that “the work economists have done on single-sided firms does not provide much guidance for evaluating the conduct of multi-sided firms.”<sup>39</sup>

Lastly, when it comes to efficiencies, the main takeaway is that by increasing demand on one side a platform can increase its value to agents on the other sides through indirect network externalities, which “is a real social benefit, and the platform is unlikely to be able to capture it all.”<sup>40</sup> Furthermore, a platform could increase overall consumer welfare if it increased the value it delivered by more than it increased the prices it charged. In evaluating changes, regulators should consider overall consumer welfare as opposed to focusing solely on losses to one group

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<sup>37</sup> Evans & Noel, *The Analysis of Mergers that Involve Multisided Platform Businesses*, *supra* note 36, at 672.

<sup>38</sup> Evans & Schmalensee, *supra* note 29, at 23–35 (collecting studies).

<sup>39</sup> *Id.* at 28.

<sup>40</sup> *Id.* at 35.

of consumers while ignoring gains by another group.<sup>41</sup>

## II. Part I, Chapter 1 on Resale Price Maintenance

For the reasons set forth below, we strongly urge the following revisions to Part I, Chapter 1:

In cases where, as one aspect of marketing activities or upon a distributor's request, an enterprise restricts sales price of distributors, ~~it is in principle illegal as unfair trade practices, because it reduces or eliminates price competition among distributors that conduct will be evaluated under an effects-based analysis, so that it will be condemned only if any anticompetitive effects outweigh any procompetitive benefits created by the practice.~~

“Economists nearly universally agree that while minimum RPM can generate anticompetitive outcomes in some instances, the empirical evidence indicates such agreements are more often than not procompetitive.”<sup>42</sup> Among the early empirical evidence on RPM is a 1983 report by Thomas Overstreet analyzing 68 FTC RPM cases from mid-1965-1982 and surveying the empirical studies on RPM available at the time.<sup>43</sup> Overstreet observed that an overwhelming number of the RPM cases brought and resolved by the FTC occurred in markets that were not conducive to either dealer or manufacturer collusion, and therefore concluded that RPM agreements generally are procompetitive.<sup>44</sup> Overstreet's survey of the existing empirical work showed that although RPM can have both socially desirable and undesirable consequences, the studies did not support the conclusion that RPM agreements are more often than not anticompetitive.<sup>45</sup>

In a 1991 study, Pauline Ippolito reviewed 203 litigated RPM cases reported from 1975 through 1982, concluding that they were generally inconsistent with theories of dealer or manufacturer collusion.<sup>46</sup> In particular, Ippolito observed that allegations of horizontal price-fixing in these cases was exceedingly rare—appearing only 9.8 percent of the time in private cases and 13.1 percent of the time over all cases—even though that claim logically would have been included by plaintiffs if they had any evidence that the RPM arrangements in question

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<sup>41</sup> *See id.*

<sup>42</sup> Joshua D. Wright, Comm'r, Fed. Trade Comm'n, *The Economics of Resale Price Maintenance & Implications for Competition Law and Policy*, Remarks Before the British Institute of International and Comparative Law 16 (2014), [https://www.ftc.gov/system/files/documents/public\\_statements/302501/140409rpm.pdf](https://www.ftc.gov/system/files/documents/public_statements/302501/140409rpm.pdf) (collecting studies).

<sup>43</sup> THOMAS R. OVERSTREET, JR., BUREAU OF ECON., FED. TRADE COMM'N, *RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE* (1983).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991).

reflected dealer or manufacturer collusion.<sup>47</sup> Moreover, most of the cases offered facts suggesting procompetitive justifications for the use of RPM. This led Ippolito to conclude that “service- and sales-enhancing theories, taken together, appear to have greater potential to explain the [RPM] practices” than do collusion-based explanations.<sup>48</sup>

Two more recent empirical surveys summarizing the empirical literature on vertical restraints offer additional evidence casting doubt on the proposition that minimum RPM is always or even usually anticompetitive. The first, authored by a group of Department of Justice (DOJ) and FTC economists, reviews twenty-four papers published between 1984 and 2005 providing empirical effects of vertical integration and vertical restraints.<sup>49</sup> The study offers a careful synthesis of the evidence and observes that “empirical analyses of vertical integration and control have failed to find compelling evidence that these practices have harmed competition, and numerous studies find otherwise.”<sup>50</sup> While only a handful of the selected studies involve only RPM rather than additional forms of vertical restraints, the authors go on to conclude that while “[s]ome studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition.”<sup>51</sup>

The second recent empirical survey, by former-FTC Director of the Bureau of Competition Francine Lafontaine and Margaret Slade, reviews twenty-three papers, including some in the study prepared by the DOJ and FTC economists.<sup>52</sup> Lafontaine and Slade reach a similar conclusion, stating that “it appears that when manufacturers choose to impose restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision . . . the evidence thus supports the conclusion that in these markets, manufacturer and consumer interest are apt to be aligned.”<sup>53</sup>

In an even more recent analysis of RPM, along with the related practices of exclusive territories and forward integration, FTC economist Dan O’Brien notes that three additions to the literature provide new evidence that such restraints mitigate double marginalization and promote retailer effort.<sup>54</sup> O’Brien goes on to conclude that, “with few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons,” and supports “a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases.”<sup>55</sup>

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<sup>47</sup> *Id.* at 281.

<sup>48</sup> *Id.* at 291-92.

<sup>49</sup> Cooper, et al., *supra* note 2.

<sup>50</sup> *Id.* at 658.

<sup>51</sup> *Id.*

<sup>52</sup> Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, in *HANDBOOK OF ANTITRUST ECONOMICS* 391 (Paolo Buccirossi ed., 2008).

<sup>53</sup> *Id.* at 22.

<sup>54</sup> O’Brien, *supra* note 2.

<sup>55</sup> *Id.* at 76.

The robust empirical literature that has examined the competitive effects of minimum RPM does not suggest that minimum RPM arrangements “usually have significant anticompetitive effects,” and we urge the JFTC to reconsider both its statement regarding the general effects of minimum RPM and its approach to regulating RPM through antitrust or competition laws. With respect to measuring the welfare effects of minimum RPM, agencies need to assess both price and output effects. This is because, “[f]rom a consumer welfare perspective, measuring the effect of minimum RPM on price alone tells us little about the competitive effects of minimum RPM because both procompetitive and anticompetitive theories predict higher prices, all else equal. Analyzing the effect of minimum RPM on output, where the theories offer predictions in opposing directions, resolves this problem.”<sup>56</sup>

### III. Part I, Chapter 2.7 on Tying

We commend the JFTC for recognizing the potential procompetitive benefits of tying and for stating that tying “alone does not automatically pose problems” under the Antimonopoly Act absent foreclosure effects. We note, however, that Part I, Chapter 2.7 also states that tying shall constitute an illegal unfair trade practice “if it tends to impede freedom of choice of customers and is unjustifiable as competition means from a viewpoint of on the merits focusing on price, quality, and service.” For the following reasons, we strongly urge that this provision be omitted.

First, tying is ubiquitous and widely used by a variety of firms and for a variety of reasons.<sup>57</sup> In the vast majority of cases, package sales are “easily explained by economies of scope in production or by reductions in transaction and information costs, with an obvious benefit to the seller, the buyer or both.”<sup>58</sup> Those benefits can include lower prices for consumers, facilitating entry into new markets, reducing conflicting incentives between manufacturers and their distributors, and mitigating retailer free-riding and other types of agency problems.<sup>59</sup> Moreover, because of the widespread procompetitive use of tying by firms without and firms with market power, making tying per se or presumptively unlawful (i.e., absent evidence of net anticompetitive effects) is likely to generate many Type I (false positive) errors which, as the

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<sup>56</sup> Wright, *supra* note 42, at 16.

<sup>57</sup> See, e.g., Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling By Firms?: A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707, 707–08 (2005); see also THOMAS T. NAGLE & REED K. HOLDEN, *THE STRATEGY AND TACTICS OF PRICING: A GUIDE TO PROFITABLE DECISION MAKING* (3d ed. 2002); David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. ON REG. 37 (2005); Stefan Stremersch & Gerard J. Tellis, *Strategic Bundling of Products and Prices: A New Synthesis for Marketing*, 66 J. MARKETING 55 (2002).

<sup>58</sup> Kobayashi *supra* note 57, at 708; see also David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practice: A Neo Chicago Approach*, 72 U. CHI. L. REV. 27 (2005); Stremersch & Tellis, *supra* note 57, at 70.

<sup>59</sup> Kobayashi, *supra* note 57, at 708; see also Bruce H. Kobayashi, *Two Tales of Bundling: Implications for the Application of Antitrust Law to Bundled Discounts* (George Mason Univ. Sch. of Law, Law & Econ. Working Paper No. 05-27 (2005)).

U.S. Supreme Court has explained, “are especially costly, because they chill the very conduct the antitrust laws are designed to protect.”<sup>60</sup>

Second, as the U.S. Supreme Court has observed, the fact that “a purchaser is ‘forced’ to buy a product he would not have otherwise bought even from another seller” does not imply an “adverse effect on competition.”<sup>61</sup> Alden Abbott and Joshua D. Wright explain:

This . . . statement [by the U.S. Supreme Court] suggests that bundling would not constitute unlawful tying if the purchaser simply desires to purchase less than the entire bundle of products offered for package sale at a reduced price. Rather, to prevail on an unlawful tying or bundling claim, the plaintiff (or agency) would have to show an exclusionary effect on other sellers as a result of the plaintiff’s thwarted desire to purchase substitutes for one or more items in the bundle from other sources that harms competition in the market for the tied product.<sup>62</sup>

As such, we strongly urge that “freedom of choice” be eliminated as a ground for condemning the widespread practice of tying, and that the JFTC instead limit liability to widely accepted economically-based theories of harm, such as leveraging and monopoly maintenance.<sup>63</sup>

#### IV. Part II, Chapter 3 on Primary Refusals to Deal by a Single Enterprise

For the reasons set forth in the Introduction, above, we strongly recommend the deletion of the language in Part II, Chapter 3 indicating that a refusal to deal that “tends to make it difficult for the refused competitor to carry on normal business activities” constitutes an illegal unfair trade practices.

In addition to the reasons set forth in the Introduction, it is important to consider that potential inventors may be less likely to undertake the research and development that lead to an invention or new products if the inventor’s reward for its efforts is reduced by having to share its product or intellectual property right.<sup>64</sup> Similarly, if businesses know they can easily gain access to the goods or intellectual property rights of other firms, then they have less incentive to

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<sup>60</sup> *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004) (internal quotation marks omitted).

<sup>61</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16, 31 (1984).

<sup>62</sup> Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, in 4 *ENCYCLOPEDIA OF LAW AND ECONOMICS: ANTITRUST LAW AND ECONOMICS* 183, 190 (Keith N. Hylton ed., 2d ed. 2010).

<sup>63</sup> Koren W. Wong-Ervin et al., *Tying and Bundling Involving Standard-Essential Patents*, 24 *GEO. MASON L. REV.* (forthcoming 2017).

<sup>64</sup> See, e.g., O’DONOGHUE & PADILLA, *supra* note 9; J. Gregory Sidak, *How Does the Experience of U.S. Telecommunications Regulation Inform the Forced Sharing of Intellectual Property Rights under Global Competition Law?* (Criterion Econ. Working Paper, 2012), <https://ssrn.com/abstract=2061895>.

innovate and more incentive instead to free-ride on the risky and expensive research of others.<sup>65</sup> The implication of this analysis is that requiring businesses to deal with competitors is likely to result in less innovation, which will harm consumers in the long run.

### **CONCLUSION**

We appreciate the opportunity to comment and would be happy to respond to any questions the JFTC may have regarding this comment.

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<sup>65</sup> See *Trinko*, 540 U.S. at 408.