CPI's Asia Column Presents:

Problematic Aspects of the Japan Fair Trade Commission's Proposed Distribution Guidelines

By Koren W. Wong-Ervin[*]

(Global Antitrust Institute)

May 2017

COMPETITION POLICY INTERNATIONAL

In April 2017, the Japan Fair Trade Commission (JFTC) released its proposed revisions to its Guidelines Concerning Distribution Systems and Business Practices Under the Antimonopoly Act (Draft Guidelines). While the Draft Guidelines appropriately recognize that vertical restraints may have either pro- or anticompetitive effects, there are a number of troubling aspects, which were identified by the Global Antitrust Institute (GAI) at Scalia Law School at George Mason University in its comment to the agency.[1] These include:

1. Presumptions of illegality for conduct such as minimum resale price maintenance (RPM);

2. Failure to require proof of actual anticompetitive effects while requiring proof of actual procompetitive benefits;

3. Failure to require substantial but-for foreclosure, which includes an analysis of the counterfactual world 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;

4. Vague and ambiguous standards for unfair trade practice liability, for example, prohibiting unilateral refusals to deal that "tend to make it difficult for the refused competitor to carry on normal business activities";

5. Impositions of unfair trade practice liability for vertical restraints that "tend[] to impede fair competition" without requiring either dominance or a showing of actual harm to the competitive process; and

6. Seeming presumptions that network effects create either market power or barriers to entry, without requiring a fact-specific case-by-case analysis with empirical backing on the presence and effect of any network effects.

Minimum RPM

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 minimum 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,[2] the GAI

---

* Koren W. Wong-Ervin is the Director of The Global Antitrust Institute at Scalia Law School at George Mason University, an Adjunct Professor at Scalia Law, and former Counsel for Intellectual Property and International Antitrust at the U.S. Federal Trade Commission.

1 GAI's full comment is available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2962970.

2 *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 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.").

urged the JFTC to reconsider its approach, and instead 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.

With respect to measuring the welfare effects of minimum RPM, the GAI noted that 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."[3]

Foreclosure and Price-Maintenance Effects

The Draft Guidelines identify two types of effects of vertical non-price restraints, "foreclosures effects" and "price maintenance effects." The GAI urged 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 recommended 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."[4] "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."[5] "[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."[6]

GAI also strongly urged 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."[7] Such an approach to assessing foreclosure isolates any true competitive effect of the allegedly exclusionary agreement from other factors.

---

[3] 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 (collecting studies).

[4] Benjamin Klein, *Exclusive Dealing as Competition for Distribution "On the Merits"*, 12 GEO. MASON L. REV. 119, 122–28 (2003) [hereinafter Klein].

[5] 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).

[6] Klein, *supra* note 4, at 126.

[7] Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1165 (2012).

Lastly, we recommended that 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.[8] With respect to price increases, it is important to recognize and consider other factors, including changes in the product and changes in demand, that may explain higher prices.[9]

Refusals to Deal

Part II, Chapter 3 of the Draft Guidelines 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." The GAI strongly urged 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."[10] 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."[11]

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.[12]

---

[8] *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.

[9] *Id.* ¶¶ 107–08.

[10] ROBERT O'DONOGHUE & JORGE PADILLA, THE LAW AND ECONOMICS OF ARTICLE 102 TFEU 518–19 (2d ed. 2013).

[11] *Id.*

[12] *Id.*

Unfair Trade Practices

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 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.

The GAI strongly urged the JFTC to adopt the approach taken by the U.S. Federal Trade Commission in its 2015 *Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act*, in which the agency stated that it 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.[13]

Multi-Sided Platforms and Network Effects

The GAI commended the JFTC for recognizing that standard antitrust analysis applies to conduct by multi-sided platforms. However, it strongly urged 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.[14] 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."[15] "As in all analysis

[13] 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.

[14] *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).

[15] *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)).

of network effects, the standard assumption that quantity alone determines the strength of the effect is likely mistaken."[16] 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.[17] "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."[18]

[16] Manne & Wright, *supra* note 14 at 208.

[17] *Id.*

[18] *Id.*