

**UNITED STATES FEDERAL TRADE COMMISSION
AND DEPARTMENT OF JUSTICE RESPONSE**

**SURVEY ON COMPETITION LAW IN
SMALL ECONOMIES**

Special Project for the 2009 ICN Annual Conference

1. Analytical Framework

The application of competition law in a small economy brings into play the notion of the State (“law”) and the notion of a social fact (“economy”). While the economy is given and constitutes a fact of life, the State which has the power to adopt the legal system governing the functioning of its economy, is created by law and defined by boundaries which may not coincide with the “size” of the economy. The “effects doctrine” translates the mutual international understanding that each State has the right to organize its market and to protect it, if it chooses to do so, against anticompetitive behaviour that affects it, independently of the place where this behaviour originates, and independently of the fact that a small economy may more often be exposed to anticompetitive behaviour which originates in another State.

These observations give rise to the general question which can be formulated as follows:

Does the size of the economy affect the application of competition law, and if so how?

The question raises at the outset the problem of the definition of the size of a (small) economy. It then can and must be restated in more concrete terms, depending on the context in which the question comes up.

The United States is not a small economy. However, we have had experience in matters involving small markets, which are not the same as “small economies” but may be analogous in some respects. We apply the same fundamental analytical framework for assessing anticompetitive conduct in both small and large markets. Size, however, may along with other factors impact the factual market conditions to which the analysis is applied. In addition, a jurisdiction’s openness to international trade, its governing laws and regulations, and its geographic or political isolation may each impact the free flow of particular goods and services in various ways relevant to, for example, market definition and ease of entry.

2. The Notion of a “Small Economy”

For the purpose of this Survey, an “economy” in the context of competition law refers to a distinct legal jurisdiction, defined by borders and governed by legal institutions empowered to enact and enforce a competition law regime.

The “smallness” of such an economy depends on the framework in which we operate the comparison. Possible criteria to be used include, *inter alia*, the following:

- Size of the economy, in terms of GDP;
- Size of the territory, in which the economy “takes place” and its geographic location;
- Population in absolute terms, or population compared to the neighbouring economies;
- Legal, cultural, social and historical differences compared to the neighbouring economies;
- Comparative importance or size of the undertakings, or of the number of global players which have their seat in the territory of a small economy, etc.
- Degree of regional economic integration, including entry barriers, dependence on inter-national trade, economic ties with neighbouring countries.

Analysis of the above abstract criteria brings us to the following questions, most notably:

- Are the abovementioned criteria adequate in your view?
- How do you define your economy (“large” or “small”)? By which standards? How do you define the size of your neighbouring economies or major trading partners?

The United States is a large economy by any measure. As illustrated by the range of potential criteria listed above, however, the notion of a “large” or “small” economy can have very different meanings depending on the criteria used to define the term. When discussing “large” or “small” economies, it would be useful to define what is meant by the use of these terms in each particular context in order to create a consistent basis for the discussion and to avoid confusion. The adequacy of any particular criteria will depend on the context in which they are used.

3. Anticompetitive Agreements

Anticompetitive agreements are the best analysed and least controversial part of competition law. There will probably be fewer differences in the application of competition law in this respect. But the fact that people and operators know more about each other in smaller economies than in larger ones may make a difference. To this end the role on information, information sharing and networking mechanisms may play a significant role in facilitating collusion. The limitation of the relevant market by state borders may make another difference.

- How, if at all, should such elements be taken into account? What is the importance of open borders in this context? Is there evidence for more oligopolies in small economies? If so, what type of competition policy is best suited to cope with the implications that oligopolies have on competition? Could the enhanced risk of collusion and anti-competitive conduct justify harsher sanctions or a different focus of the competition laws?

The experience of the United States in anti-cartel enforcement has ranged from very small, localized markets in different parts of the U.S. to large international cartels. We have seen collusion and anticompetitive conduct in a wide range of jurisdictions and markets. In the international cartel arena, we have seen no indication that multinational cartels target small economies more than large economies, or that international cartels otherwise operate differently with respect to small and large economies. In the international cartel context, the most significant jurisdictional distinction we have found is that some cartels that violated competition laws around the world chose not to extend cartel activity to U.S. markets, because they feared detection and sanctions.

The United States Department of Justice has long pursued a policy of strict enforcement against all cartel activity, with anti-cartel enforcement as our highest antitrust priority. In more than 110 years of experience in this area, we have investigated a wide range of cartels in different industries, many operating in highly concentrated industries or in small geographic markets where market participants have a high degree of knowledge about, and familiarity with, one another. For example, some of our price-fixing and bid-rigging cases have involved local cartels operating in “small markets” such as individual U.S. states or municipalities. To date, we have not identified any significant patterns or differences in the cartels in such industries versus others that would lead us to change our focus or enforcement approach based on any of the factors outlined in this question.

It is important to distinguish anticompetitive hard core cartel agreements, such as price fixing, bid rigging, and horizontal customer and territorial allocation, from facilitating practices, i.e., practices that make it easier for parties to coordinate price or other behavior in an

anticompetitive way, which may include certain forms of information sharing. Facilitating practices most commonly arise in oligopolistic markets, which occur in the U.S. and other larger economies, as well as in small economies. The U.S. agencies examine facilitating practices, including with respect to oligopolistic markets, on a case-by-case basis in light of their individual purposes and effects. We are not aware of any reason to apply a different analysis in small, as opposed to large, economies.

- Vertical restraints are often linked to imports in small economies. Does this require or justify a different analysis of vertical restraints, especially of resale price maintenance and of parallel import bans, in small economies? Moreover, could the fact that the risk of foreclosure is higher justify a different analysis?

Vertical restraints are common in both large and small economies. Although vertical restraints may have an anticompetitive effect in some circumstances, they also may promote competition by allowing vertically related firms to structure their relationships in a way that improves their ability to compete against rivals. Therefore U.S. courts do not condemn vertical restraints as *per se* illegal, but rather first consider their actual effect on consumers (see e.g. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* 127 S. Ct. 2705 (2007)).

We are not aware of any empirical evidence indicating whether or not vertical restraints are linked more often to imports in small economies than in large ones, or whether the risk of foreclosure by vertical restraints is relatively higher in small economies than in large ones. While vertical restraint issues can arise in small markets, as in large ones, we have not seen any indication that vertical restraints raise unique analytical issues in small versus large markets, and we are aware of no reason why a different framework for analysis should apply to the assessment of any type of vertical restraint based merely on market size. Determining the competitive effects of vertical restraints requires a case-by-case analysis, based upon an evaluation of the markets and restraints involved. While size may affect the factual market conditions assessed, in our experience the core analysis of market power, risk of foreclosure, and competitive effects remains the same regardless of market size.

4. Abuse of Dominance

It is likely that the number of large firms and their respective weight affect small economies more than large economies. State monopolies might also be more common in small economies than in large ones. Economies of scale may call for these sizes and at the same time limit the number of viable companies within the territory of such a small economy.

Since small economies may not be able to accommodate too many competitors in each industry, more emphasis might be put on efficiency considerations.

- Does this mean that a specific regime should apply to the conduct of dominant undertakings in a small economy? Or does this make no difference? Is there a different approach towards collective dominance issues?

Many economies, large and small, suffer the impact of formerly government-owned or supported dominant firms that maintain advantages over competitors. There appears to be no empirical evidence indicating whether or not state monopolies are more common in small economies than in large ones. While the United States has limited experience with large state-owned or state-controlled monopolies, our observations of the experience of other countries suggest that large and small economies generally face similar issues, and use similar instruments, in seeking to open up such markets to competition. Many countries employ a combination of regulatory and antitrust instruments to introduce competition in these markets. The U.S. experience with regulated industries has taught us the importance of competition advocacy to alert regulators to the potential for regulation to erect barriers to entry or otherwise chill market processes.

The ICN Recommended Practices on State-Created Monopolies Analysis Pursuant to Unilateral Conduct Laws¹ provide sound general guidance, equally applicable to large and small economies, on addressing unilateral conduct issues relating to state-created monopolies, and the privatization or liberalization thereof.

With respect to unilateral conduct, the ICN Recommended Practice on Dominance/Substantial Market Power Analysis Pursuant To Unilateral Conduct Laws, states, *inter alia*, that “[t]he analytical framework used to assess market power is the same in small and/or isolated economies.”² Consistent with this view, the U.S. believes that the antitrust analysis standard applied in “small economies” should not be different from the one applied in “large economies.” Regardless of the size of an economy, the key consideration is to ask whether a firm with substantial market power engaged in anticompetitive conduct that significantly undermined the competitive process. If it did not engage in such anticompetitive conduct – *e.g.* if it is merely charging a monopoly price (see *Verizon Communications v.*

¹ Available at http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/Unilateral_WG_2.pdf.

² See Recommended Practice III.9. of the ICN RECOMMENDED PRACTICES FOR DOMINANCE/SUBSTANTIAL MARKET POWER ANALYSIS PURSUANT TO UNILATERAL CONDUCT LAWS,, available at http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/Unilateral_WG_1.pdf.

Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004)) and exploiting market power it obtained legitimately – its conduct should not be proscribed, because such a prohibition may undermine *ex ante* incentives to innovate and engage in legitimate behavior that may create market power. Such legitimate behavior is at the heart of the competitive process and should not be discouraged. Discouraging it chills the competitive process and may curtail economic growth and efficiency. Thus, a scenario of a single market player, even in a market previously characterized by multiple players, is not necessarily the result of anticompetitive conduct. Such a scenario could, *inter alia*, be the result of successful competition on the merits, or market conditions in which less efficient firms cannot survive.

While we believe that the fundamental analysis used to assess unilateral conduct is the same in both large and small economies, we recognize that, in some cases, a jurisdiction’s size may affect the facts to which the analysis is applied. As noted in the commentary to the Recommended Practices on Dominance/Substantial Market Power Analysis Pursuant to Unilateral Conduct Laws, factors such as an economy’s relative size and openness to trade may impact the assessment of barriers to entry, and may therefore influence the ultimate outcome of a dominance/substantial market power assessment.³ Thus, the size of an economy, along with other factors, may play a role in unilateral conduct analysis to the extent that it impacts market conditions relevant to the analysis.

The U.S. agencies do not believe that collective dominance should be proscribed through application of unilateral conduct law because in our experience, it is impossible to use this theory to distinguish rational and legitimate competitive responses from anticompetitive behavior. In addition, in our experience, in the absence of an agreement among competitors, it is extremely difficult to construct a remedy that is pro-competitive and does not require the competition agencies to engage in price regulation or industry restructuring.

5. Mergers

Competition law enforcers in small and large economies alike, aim at maintaining an effective and efficient merger control regime. To this end, the size of the economy as well as other specific market conditions might affect the optimal design of a merger policy. Subsequently, merger regimes in small economies might exhibit certain features that reflect their specific market conditions and address potential competitive concerns which are relevant to the size of their economy.

This fact may matter with respect to factors concerning the substantive appraisal of the merger, such as the role of imports as a competitive

³ See comment to Recommended Practice III.9. of the ICN Recommended Practices for Dominance/Substantial Market Power Analysis Pursuant to Unilateral Conduct Laws, *Id.*

constraint, as well as of the procedural aspects of the merger, such as the appropriate notification duties and thresholds. This may lead to the following questions:

- Are there any differences with respect to the substance of the merger control regime? Are there different justifications for having a merger control regime in small economies? Should there be different guidelines for geographic market definition? How might the size of the economy affect the application of legal presumptions? Which types of remedies are best suited for small economies?

Merger analysis and the merger control regime should not differ based on whether an economy is “small” or “large.” A particular product and geographic market may be very concentrated in a large economy and not at all concentrated in a small economy; it depends on the particular facts. We believe the analysis embodied in the ICN Merger Guidelines Workbook⁴ -- which is consistent with the U.S. Horizontal Merger Guidelines⁵ -- should apply. Remedies should be targeted to resolve the competitive problem created by an anticompetitive merger. Although the remedy should always be sufficient to redress the antitrust violation, the purpose of the remedy is not to enhance premerger competition but to restore it. Typically a structural remedy (full divestiture of an existing business unit) is preferable to a behavioral remedy. Once again, however, remedies should not depend on the size of the economy; rather, they should depend on the facts at hand in the particular market. Legal presumptions should not be affected. Moreover, it would be a mistake to excuse an anticompetitive merger aimed at creating a “national champion” whether the economy is a “large” or a “small” one. Academic learning indicates that such a policy would harm consumers, undermine competition, and quite possibly undermine the competitiveness of key sectors in the nations that engage in such an ill-advised policy.⁶

- On the level of the procedural regime, what are the appropriate criteria triggering an intervention or an inquiry into a merger project: turnover thresholds; structural criteria, such as the degree of organisational integration (existence of branches or subsidiaries) of one or both of the merging companies; effect on competition? Should there be a mandatory or a voluntary notification regime, with or without a prohibition to proceed without clearance?

Merger review in the U.S. has worked well with a suspensive mandatory pre-merger notification regime. Regardless of whether

⁴ Available at http://www.internationalcompetitionnetwork.org/media/library/conference_5th_capetown_2006/ICNMergerGuidelinesWorkbook.pdf.

⁵ Available at <http://www.ftc.gov/bc/docs/hmg080617.pdf>.

⁶ See, e.g., Michael Porter, *THE COMPETITIVE ADVANTAGE OF NATIONS* (1990), at 662; and William Lewis, *THE POWER OF PRODUCTIVITY: WEALTH, POVERTY, AND THE THREAT TO GLOBAL STABILITY* (2004), at 24-25.

notification is required pre- or post-closing, we recommend that the filing requirement be based on turnover of at least two of the merging parties or the target in the reviewing jurisdiction, consistent with ICN Recommended Practices for Merger Notification and Review Procedures. The experience of many ICN members suggests that subjective criteria, such as effects on competition, are not appropriate for determining whether a transaction is notifiable. Thresholds based on objective criteria, as described above, constitute internationally-recognized best practice in defining the type of transactions that need to be notified.⁷ Regarding the definition of transactions, the ICN's report on "Defining 'Merger' Transactions for Purposes of Merger Review"⁸ offers detailed information on what works well in the U.S. and other jurisdictions.

One area where the U.S. system is different from certain other systems is that notification thresholds are not jurisdictional, allowing the agencies to investigate transactions that are not required to be notified. This model may prove useful for other jurisdictions as well.

As described above, the criteria for analysis should be based on likely effects on competition, consistent with the analysis set forth in the ICN Merger Guidelines Workbook.

⁷ See Recommended Practice II.B of the ICN RECOMMENDED PRACTICES FOR MERGER NOTIFICATION PROCEDURES, available at <http://www.internationalcompetitionnetwork.org/media/archive0611/mnprecp practices.pdf>; and Recommendation A.1.2.2 of the OECD Council RECOMMENDATION ON MERGER REVIEW, available at <http://www.oecd.org/dataoecd/3/41/40537528.pdf>.

⁸ Available at http://www.internationalcompetitionnetwork.org/media/library/conference_6th_moscow_2007/23ReportonDefiningMergerTransactionsforPurposesofMergerReview.pdf