COMMENTS OF THE AMERICAN BAR ASSOCIATION'S SECTIONS OF ANTITRUST LAW AND INTERNATIONAL LAW ON DRAFT GUIDELINES ISSUED BY THE HONG KONG COMPETITION COMMISSION AND COMMUNICATIONS AUTHORITY REGARDING THE FIRST CONDUCT RULE AND THE SECOND CONDUCT RULE UNDER THE COMPETITION ORDINANCE

December 19, 2014

The Sections of Antitrust Law and International Law of the American Bar Association ("ABA") (together, the "Sections") welcome the opportunity to comment on the Draft Guideline on The First Conduct Rule ("Draft First Conduct Rule Guideline"), and Draft Guideline on The Second Conduct Rule ("Draft Second Conduct Rule Guideline") (together, the "Draft Guidelines") issued by Hong Kong's Competition Commission and Communications Authority (the "Commission" and "Authority"). The Sections commend the Commission and Authority for their commitment to provide comprehensive, transparent, and practical guidelines for businesses, their legal advisors and others concerned with compliance with the Competition Ordinance ("Ordinance"), and their decision to solicit public comments. Providing for public comments helps both to gain support for the enforcement efforts and approach of the Commission and Authority, and to identify concerns, questions and ambiguities before enforcement begins.

The Sections' comments are the work of members of the Sections who practice competition law in the United States, Canada, the European Union and other jurisdictions around the world. The Sections are generally very supportive of the content of the Draft Guidelines. Our comments suggest (i) clarifications regarding the definitions of "market power", "services of general economic interest," "services of an economic nature," and the methods of determining a relevant market, (ii) clarification regarding the interaction among the concepts of "cartels", "anti-competitive object," and "serious anti-competitive conduct", (iii) removing resale price maintenance ("RPM") from the category of conduct that is anti-competitive "by object" and clarifying the analysis of efficiencies that may result from RPM, (iv) greater consideration of the likelihood of recoupment in cases of potential predatory pricing and balancing of the consumer impact of possible margin squeezes with the impact on competitors, (v) clarification of the analysis of exclusive dealing relationships, and (vi) caution in adopting an essential facilities doctrine, especially in the context of intellectual property rights.

A. Market Definition and Market Power under the First and Second Conduct Rules

1. Market Power and Market Definition

Paragraph 3.15 of the Draft First Conduct Rule Guideline defines "market power" as the "ability to profitably maintain prices above competitive levels for a period of time or to profitably maintain output in terms of product quantity, quality and variety or innovation below competitive levels for a period of time". Paragraph 3.2 of the Draft Second Conduct Rule Guideline states that "[s]ubstantial market power can be thought of as the ability profitably to charge prices above competitive levels, or to restrict output or quality below competitive levels, for a sustained period of time."[1] (Footnotes omitted.) The Draft Guidelines state that the Commission will consider a number of factors in assessing whether market power or substantial market power exists, including market share, countervailing buyer power, barriers to entry or expansion, and market specific characteristics.[2] In addition to the factors set forth in the Draft Guidelines, the Commission and Authority might consider providing that they will also examine whether practices at issue have changed a preexisting competitive equilibrium or maintained a competitive equilibrium that might have changed but for the practices under review. The Commission and Authority might also explain in the final Guidelines that direct evidence of anticompetitive effect may in some cases, where reliably established, be useful in confirming the existence of market power. The final Guidelines might include one or more hypothetical examples to provide further guidance on this point. For example, in the final First Conduct Rule Guideline, a hypothetical example might be added to illustrate changes in price before and after implementation of the practice or agreement at issue. Similarly, in the final Second Conduct Rule Guideline, a hypothetical example might be included to demonstrate the use of direct evidence of anticompetitive effect before and after the exclusionary conduct.

2. Different Market Power Standards for First and Second Conduct Rules

The Sections suggest that the Commission and Authority explain in greater detail the distinction between "substantial market power" that is required under the Second Conduct Rule and "market power" that is referred to in the First Conduct Rule. It is generally recognized that substantial degree of market power requires a higher (if not much higher) degree of market power than mere market power. The courts in the U.S. make a similar distinction between market power and monopoly power for concerted and unilateral conduct, respectively. Concerted conduct can be condemned without any finding of monopoly, whereas unilateral conduct is generally acceptable unless it results in, maintains or has a dangerous probability of resulting in a monopoly. The Commission and Authority may wish to consider including similar language in the final guidelines. For example, a concerted conduct can be an infringement of the First Conduct Rule when the undertakings, individually or collectively, possess market power (but not necessarily substantial market power), whereas an infringement of the Second Conduct Rule will generally require a finding of substantial market power. The Draft Guidelines appear to suggest that the difference between "market power" and "substantial market power" turn primarily (or solely) on a temporal dimension ("period of time" versus "sustained period of time"). The Sections suggest that Commission and Authority provide practical guidance on this distinction.

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[1] See also Draft Second Conduct Rule Guideline ¶¶1.4, 3.4 and 3.6.

[2] Draft First Conduct Rule ¶3.17; Draft Second Conduct Rule ¶3.8.

3. The Cellophane Fallacy

The Draft Second Conduct Rule Guideline adopts the "small but significant and non-transitory increase in price" ("SSNIP") test in determining a relevant product market,[3] and recognizes that care must be taken to avoid the "Cellophane Fallacy"[4] in applying the SSNIP test.[5] Hypothetical Examples 1[6] and 2[7] illustrate straight-forward examples of the application of the SSNIP test in which the original prices are explicitly or implicitly assumed to be increased from the competitive level. The Commission and Authority may wish, however, to add a hypothetical or further explanation of how they will avoid the Cellophane Fallacy when prevailing prices are above competitive levels.

B. Draft First Conduct Rule Guideline

1. "Services of general economic interest" and "Services of an economic nature"

Section 3, Schedule I of the Ordinance exempts "services of general economic interest" from both the First and the Second Conduct Rules to the extent they would impede the performance of those services. Paragraph 4.7 of the Annex to the First Conduct Rule Guideline states that "[s]ervices of general economic interest are services that the public authorities believe should be provided to the public whether or not the private sector would supply the relevant services". Paragraph 4.2 of the Annex to the Draft First Conduct Rule indicates that the Commission will interpret the general exclusion strictly with the onus on the party seeking the benefit of the exclusion to demonstrate that all conditions have been met, while ¶4.3 provides that the entity has the burden of demonstrating it has been "expressly entrusted", not merely approved. Moreover, the exclusion applies only to the specific entrusted task (¶4.4), and that obligations imposed on an undertaking entrusted with the service must be linked to that service of general economic interest and contribute directly to achieving that interest in order to fall within that entrustment (¶4.5). The Sections commend the Commission's and the Authority's narrowing approach to the exclusion, and suggest that the Commission and the Authority may wish to consider adding a new second sentence to ¶4.2 of the Annex to the Draft First Conduct Rule: "Although the Commission recognises the need to ensure the provision of certain services which the market would not otherwise provide, it considers that, in the majority of cases, the free

[3] Draft Second Conduct Rule Guideline ¶2.9.

[4] See, e.g., ABA Section of Antitrust Law, Antitrust Law Developments at 579 (7th Ed. 2012).

[5] Draft Second Conduct Rule Guideline ¶2.9 fn.8.

[6] Hypothetical Example 1 might be modified by introducing additional facts on the current state of competition among ready-to-drink coffee-based beverage manufacturers that suggest that the ready-to-drink coffee-based beverage business is fairly competitive, or that indicate that CoffeeCo is already exercising market power and that its conduct would entrench that power. to ensure that the Cellophane Fallacy is avoided.

[7] Similarly, Hypothetical Example 2 may also be modified to indicate that the current price charged by the Lantau paint shop is relatively competitive, even if it is the "only shop selling a particular type of specialty paint in Lantau", or that the Lantau paint shop has been exercising market power.

operation of the market will be best able to provide services of general economic interest to meet the needs of consumers".[8]

Paragraph 4.7 also provides that "services of an economic nature may include activities in the cultural, social, and public health fields where their aim is to make a profit". Paragraph 2.3 of the Draft First Conduct Rule Guideline provides that "'economic activity', while not defined in the Ordinance, is generally understood to refer to any activity consisting in offering goods or services in a market regardless of whether the activity is intended to earn a profit." The Sections suggest that ¶4.7 be revised in the final First Conduct Rule Guideline by replacing the final "where" with "regardless of whether", so that ¶4.7 would provide that "services of an economic nature may include activities in the cultural, social, and public health fields regardless of whether their aim is to make a profit" and be consistent with ¶2.3.

2. "Cartels," "Anti-competitive Object" and "Serious Anti-competitive Conduct"

The Commission and Authority may wish to clarify the interaction among ¶¶ 3.4, 3.7, 5.6, and 5.8, and the implications of ¶5.8.

Paragraph 3.4 of the Draft First Conduct Rule Guideline, relating to agreements that have the object or effect of harming competition, provides that some categories of agreements are by their nature so harmful to competition that they are conclusively deemed to have the "object" of harming competition and "there is no need to examine their effects". Agreements to fix prices, share markets, restrict output, or rig bids are "typical" examples of "cartel" agreements that are said to fall into this category.[9]

Paragraph 5.4, relating to "serious anti-competitive conduct", identifies the same categories of "cartel arrangements between competitors" -- price fixing, market sharing, output restriction and bid rigging arrangements -- to be "Serious Anti-competitive Conduct". However, Paragraph 5.3 states that "once it has been determined that an agreement has the object . . . of harming competition . . . , it becomes irrelevant whether the conduct amounts to Serious Anti-competitive Conduct . . . . " And, paragraph 5.8 states that "whether conduct falls within the category of Serious Anti-competitive Conduct is a separate determination from whether the conduct has the object or effect of harming competition".

Clarification in this area would be especially helpful given the different procedural issues implicated. Pursuant to Section 67 of the Ordinance, the Commission may issue an infringement notice in cases of Serious Anti-competitive Conduct, instead of bringing proceedings in the Competition Tribunal, suggesting that there is no need to determine additional factors.[10] In contrast, if a contravention of the First Conduct Rule does *not* involve Serious Anti-competitive Conduct, the Commission "must" issue a Warning Notice before bringing proceedings in the Competition Tribunal against the undertaking(s), so that the undertaking(s) would have "an

[8] See, e.g., Antitrust Modernization Commission, Report and Recommendations, April 2007, at viii-ix, 20-21, 333-37; Office of Fair Trading, "Services of general economic interest exclusion guideline" ¶2.18, December 2004, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284403/oft421.pdf.
[9] Draft First Conduct Rule Guideline ¶3.7.
[10] Ordinance §67.

opportunity to cease or alter the investigated conduct within a specified warning period".[11] Further, the distinction between Serious Anti-competitive Conduct and other conduct is especially relevant to small and medium-sized businesses. According to Annex 6.3 of the Draft First Conduct Rule Guideline, "[t]he general exclusion for agreements of lesser significance applies in respect of all conduct falling within scope of the First Conduct Rule other than Serious Anti-competitive Conduct".

The Sections suggest that the desired clarity may be achieved by the elimination of references to "by object", and the express adoption of the presumption that conduct identified as "Serious Anti-competitive Conduct" is anticompetitive under the First Conduct Rule.

3. Information Exchanges

The Sections are concerned that the Draft First Conduct Rule Guideline provisions on exchange of information[12] are overbroad and take insufficient account of the variety of ways information becomes available to competitors and the importance of much of such information to effective competition. Paragraph 6.32 of the Draft First Conduct Rule Guideline states that "[t]he exchange of information between undertakings may harm competition where it results in undertakings becoming aware of the market strategies of their competitors". As has been acknowledged in other jurisdictions,[13] however, information exchange is a common feature of many competitive markets and may generate various types of efficiency gains. For example, an exchange of information may solve problems of information asymmetries, thereby making markets more efficient. Moreover, companies may improve their internal efficiency through benchmarking against each other's best practices. Sharing of information may also help companies to save costs by reducing their inventories, enabling quicker delivery of perishable products to consumers, or dealing with unstable demand. Furthermore, information exchanges may directly benefit consumers by reducing their search costs and improving choice. The hypothetical example reflects many of these dynamics. The Sections suggest that the text of the final First Conduct Rule Guideline also more clearly reflect these realities, by revising ¶6.32 along the following lines: "Information is essential to effective competition, and undertakings obtain the information they need in many ways. In many cases, an exchange of information among competitors can be pro-competitive. In certain circumstances, however, an exchange of information may be used to facilitate an anti-competitive agreement or concerted practice." In addition, the Sections suggest that information exchanges standing alone should not be considered as having the object of restricting competition, and that ¶6.35 should be omitted from the final First Conduct Rule Guideline. At the least, ¶6.35 should be revised to include the word "secretly" so that the sentence reads: "When competitors secretly share information on their future intentions…"

Information exchanges regarding future prices/quantities: Paragraph 6.35 of the Draft First Conduct Rule Guideline states that "[w]hen competitors share information on their

[11] Draft First Conduct Rule Guideline ¶5.3(b).

[12] Draft First Conduct Rule Guideline ¶¶6.32-6.43.

[13] See, e.g., OECD Policy Roundtable, "Information Exchanges between Competitors under Competition Law 2010" ("OECD 2010 Report"), available at http://www.oecd.org/competition/cartels/48379006.pdf. See, also European Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements ¶57.

future intentions with respect to price (or elements of price) or quantities, the Commission will consider the information exchange as having the object of restricting competition". (Footnote omitted.) While it is true the exchange of forward-looking information may in general be more likely to be competitively sensitive than non-fresh historical information, however, not all exchanges of forward-looking information are anti-competitive. A determination should be made based on the nature of the information, the purpose of the exchange and its level of aggregation, for example. As the OECD noted, "private exchanges of firms' individual plans for future conduct, such as future prices and volumes" have been considered restrictions "by object".[14] In contrast, public statements of commitments towards customers on future prices might be pro-competitive, as they facilitate the sharing of market risks between buyers and sellers.[15]

Information exchanged via customers and suppliers: Paragraphs 6.36[16] and 6.37[17] note that competitively sensitive information need not be exchanged directly between competitors or through a trade association for the exchange to have an anti-competitive effect, and that exchanging information through a "conduit" such as a common supplier "will be" considered a form of price fixing and anti-competitive by object. There is no indication of the characteristics that make a common supplier (or customer) a "conduit".

The Sections appreciate that in some circumstances "vertical" exchanges between a supplier and a distributor may be used to implement what is actually a horizontal agreement among competing suppliers.[18] The Toys "R" Us[19] and Apple eBooks[20] cases in the United States are examples of such "hub and spoke" conspiracies. However, it is important not to unreasonably impede legitimate communications between a supplier and its distributors, and the Draft First Conduct Rule Guideline's reference to an agreement OR "simply . . . a concerted practice"[21] is vague.

The Sections are concerned that these paragraphs do not take account of the pro-competitive role played by third parties providing market information. For example, it is common for customers negotiating with suppliers to provide information about the prices offered by the suppliers' competitors, to play suppliers against each other. Such behavior is a very common part of the typical negotiating process. There may also be occasions in which a supplier may legitimately provide information to a customer about that customer's competitors. On the other hand, there may be occasions when competing sellers may utilize a common customer to exchange

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[14] OECD 2010 Report at 51.

[15] Joined Cases -89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/85 A. Ahlström Osakeyhtiö e.a. (Woodpulp II) [1993] ECR I-1307.

[16] "The exchange of competitively sensitive information may not only occur directly between competitors or indirectly through a trade association. Instead, competitors may seek to use a third party supplier or distributor as a 'conduit' for the indirect exchange of, for example, future pricing information. This may happen as the result of an agreement or there may simply be a concerted practice."

[17] "If undertakings exchange information on proposed future intentions with respect to price (for example, that they propose to comply with a particular recommended resale price) through a third party conduit (such as a common supplier), this will be considered a form of price fixing with the object of harming competition."

[18] OECD 2010 Report at 31.

[19] Toys "R" Us, Inc. v. Federal Trade Commission, 221 F.3d 928 (7th Cir. 2000).

[20] United States v. Apple, Inc., 12 Civ. 2826 (Opinion & Order, July 10, 2013, S.D.N.Y.) (DLC).

[21] Draft First Conduct Rule ¶6.36.

market information, and when competing buyers may use a common supplier to exchange information, in furtherance of an anti-competitive scheme. It would be helpful for the final First Conduct Rule Guideline to explain when a horizontal agreement will be inferred from communications between a supplier and its distributor, perhaps using hypothetical examples.

4. Vertical Price Restraints

The Sections note that the Draft First Conduct Rule Guideline appears to adopt a very strict approach to RPM despite the efficiencies which may be generated by this form of conduct, many of which are listed in the Draft First Conduct Rule Guideline itself.[22] The Sections advocate a genuine "rule of reason" standard for assessing this type of conduct. RPM is typically regarded as having a number of potential procompetitive benefits, as recognized in ¶5.5. The principal benefit is that it allows manufacturers to help ensure that their dealers have incentives to promote their products effectively, by avoiding "free riding" by other dealers who would sell the product at a lower markup without providing support to the end customer. More generally, RPM may allow manufacturers to better align the incentives of their dealers with that of the manufacturer. Thus, RPM is often used by manufacturers to expand output and enhance interbrand competition among competing suppliers. On the other hand, RPM does have the potential to create anticompetitive harm when, for example, it is used to facilitate cartel activity among dealers or to strengthen a manufacturer cartel.

By characterizing RPM as anti-competitive "by object", the Commission and Authority are at risk of blurring, at a critical stage in the development of Hong Kong's competition law culture, an important distinction between a price restriction in a vertical distribution context and price-fixing between competitors. Moreover, the Commission and Authority's current approach creates a significant inconsistency between exclusive distribution arrangements, treated "by effect", and RPM.[23]

The Sections also note that the Draft First Conduct Rule Guidelines states that "resale price maintenance may amount to Serious Anti-competitive Conduct in certain cases" on the basis that "resale price maintenance involves the supplier fixing . . . the resale price for its products".[24] The Sections respectfully disagree with an interpretation of "Serious Anti-competitive Conduct" which includes RPM, and suggest deletion of ¶5.6 from the final First Conduct Rule Guideline, for the following reasons.

(a) Contrary to the implication in footnote 15 of the Draft First Conduct Rule Guideline, the definition of "Serious Anti-competitive Conduct" in §2(1) of the Ordinance does not refer to "resale" prices. Rather, the Ordinance refers only to the "fixing, maintaining, increasing or controlling" of the price for the supply of goods/services. The Sections consider that this reflects an intention to target horizontal conduct.

[22] See Draft First Conduct Rule Guideline ¶¶6.71 – 6.74.

[23] *See Leegin Creative Leather Product, Inc. v. PSKS, Inc.*, 551 U.S. 877, 890 (2007) (citing Continental Television, Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 54-57 (1977)).

[24] Draft First Conduct Rule Guideline ¶5.6 and fn. 15.

(b) The Sections suggest that the Commission and Authority should not consider themselves to be bound by any "literal" reading of the Ordinance. Indeed, the Commission and Authority have (quite correctly in the view of the Sections) chosen *not* to adopt a "literal" interpretation regarding other forms of horizontal co-operation which technically involve the coordinated setting of price, such as legitimate joint purchasing and joint sales by a production joint venture. Nor does the Draft First Conduct Rule Guideline characterize exclusive distribution restrictions as Serious Anti-competitive Conduct, even though such restrictions involve the allocation of a territory for the supply of goods which might also be argued to fall within the definition of Serious Anti-competitive Conduct set out in §2 of the Ordinance. The Sections suggest that the Commission and Authority take the same considered approach to RPM.

(c) The Sections also consider it highly unlikely that the definition of Serious Anti-competitive Conduct was intended to capture conduct which may prove to be pro-competitive in practice. As such, the category of "Serious Anti-competitive Conduct" (and its consequences) should be reserved for horizontal cartel conduct which is, in contrast with RPM, acknowledged to involve a serious restriction of competition without further qualification.

(d) The Sections note that the category of "Serious Anti-competitive Conduct" is established as an "open" one.[25] There is therefore, in the view of the Sections, no need for the Commission and Authority to classify RPM in this manner at this stage. The Sections suggest that, should the Commission and Authority be fully committed to linking "certain cases"[26] of RPM with Serious Anti-competitive Conduct, then the final First Conduct Rule Guideline should describe those cases in greater detail. RPM which is linked to and supports a horizontal cartel might be given as an example. This is an area that could be revisited by the Commission and Authority once they have gained experience in enforcing the First Conduct Rule.

(e) Finally, the Commission and Authority may also wish to clarify how franchisor/franchisee relationships will be treated for the purposes of the First Conduct Rule. For example, according to ¶2.9, a franchisee (possibly an agent) may be considered as a separate entity from the franchisor (possibly a principal) if the franchisee bears a substantial amount of commercial risk. At the same time, in order to "ensure an orderly market" for its product and "avoid customer confusion", a franchisor may adopt a uniform pricing policy such that its product will be sold at the same retail price across all its franchisees in Hong Kong.

In adopting instead a "rule of reason" analysis for RPM, the Commission and Authority may wish to consider various alternatives in looking at the market structure of the relevant market, and the actual and potential market effects of the RPM on customers and

[25] Draft First Conduct Rule Guideline ¶5.7.
[26] Draft First Conduct Rule Guideline ¶5.6.

consumers, as well as the efficiencies that are identified in the Draft First Conduct Rule Guideline.[27]

a. Efficiencies

The Sections note that the Draft First Conduct Rule Guideline describes a number of potential efficiencies that may result from RPM.[28] The Sections commend the Commission and Authority for including these points, and suggest that further details be provided in the final First Conduct Rule Guideline in order to avoid any undue chilling effect on business. In particular, the final First Conduct Rule Guideline should describe, by reference to type of evidence, how a company may prove the various elements of the exemption criteria when RPM is being proposed. A more nuanced hypothetical may also be helpful, shedding light for example on how RPM might be used to legitimately address the problem of free riding.

C. Draft Second Conduct Rule Guideline

1. Predatory Pricing

Paragraph 5.3 of the Draft Second Conduct Rule Guideline recognizes that charging low prices is "the very essence of competition". Therefore, in order to reduce the risk of chilling such conduct that benefits consumers, the Sections suggest that the Commission and Authority consider two factors in particular in evaluating the competitive effect of low pricing by a firm with substantial market power: (1) whether market conditions are conducive to successful predatory pricing; and (2) the nature and extent of the price cutting. These factors, when considered together with actual or likely foreclosure effects, would help in distinguishing between low pricing that harms competition and low pricing that reflects healthy competition.

Paragraph 5.2 explains the circumstances in which low pricing may harm competition: when a company incurs short-run losses with the expectation that it will be able to recoup those losses and charge higher prices in the long run. For such a strategy to be rational (i.e., profitable), the company must expect that those later higher prices will make up for the losses resulting from low prices in the short run.[29] However, ¶5.6 of the Draft Second Conduct Rule makes it only discretionary, not mandatory, for the Commission and Authority to consider the possibility of recoupment.

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[27] See Leegin, 551 U.S. at 899 ("Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones."); see also Christine Varney, Assistant Attorney General, Antitrust Federalism: "Enhancing Federal/State Cooperation", Columbia Law School 7-14 (Oct. 7, 2009) (proposing "structured rule of reason" for analyzing RPM cases), available at http://www.justice.gov/atr/public/speeches/250635.pdf; In the Matter of Nine West Group, Federal Trade Commission Docket No. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, at 13-14 (May 6, 2008) (suggesting "truncated rule of reason analysis" might be applied to RPM in certain circumstances), available at http://www.ftc.gov/sites/default/files/documents/cases/2008/05/080506order.pdf.

[28] Draft First Conduct Rule Guideline ¶¶6.71-6.75.

[29] In the event that a business is profitable with low pricing because of external factors such as government support, then the analysis must factor in the "real" profit with the low pricing, and consider "recoupment" from the perspective that it may not be necessary for the business to engage profitably in predatory pricing.

The Sections recommend that the Commission and Authority consider the possibility of recoupment in all cases. Moreover, the Sections suggest that the Commission and Authority consider whether market conditions would allow for recoupment (in other words, whether a predatory strategy makes sense) *before* engaging in the difficult and time-consuming assessment of the alleged predator's prices and costs.

Such an assessment of the possibility of recoupment involves, among other things, consideration of market conditions, in particular barriers to entry and re-entry. A firm engaging in rational predatory pricing must have the confidence that its short-run "investment in predation" could be recouped over the longer run by raising prices or preventing them from declining.[30] In a market where there are low barriers to entry and/or re-entry, a predatory pricing strategy can hardly be successful, because market power that a dominant firm might have gained from price cutting will not be sufficiently durable to allow it to recoup its investment in below-cost pricing by later charging a supra-competitive price.

In addition, paragraph 5.4 of the Draft Second Conduct Rule Guideline states that a dominant firm might use predatory pricing "merely to prevent competitors from competing too vigorously", rather than to foreclose them from the market; in other words, "disciplining of competitors" may also amount to "anti-competitive foreclosure". Given the benefit to consumers of low pricing, however, the Sections caution against concluding that isolated instances of below-cost pricing is likely to have a meaningful impact on competition.[31] To harm competition, low prices must significantly disable rivals from competing, to the point that their profitable expansion in or access to a market is denied.[32]

2. Margin Squeeze

The Draft Second Conduct Rule Guideline identifies "margin squeezes" as possible abuses of substantial market power.[33] However, all else being equal, a "margin squeeze" may lead to lower prices to consumers, even while it has the effect of disadvantaging a rival. The final Second Conduct Guideline might address whether the harm to a rival resulting from the "margin squeeze", which renders the rival a less effective competitor, has also led to higher prices to the consumers, lower quality, or reduced output or innovation, relative to the scenario without the "margin squeeze".[34]

3. Exclusive Dealing

The Draft Second Conduct Rule Guideline identifies exclusive dealing by a holder of substantial market power as possible abuse of substantial market power.[35] It specifically identifies loyalty or fidelity rebates as one mechanism to implement exclusivity. As the Draft

[30] See, ICN Recommended Practice on Predatory Pricing Analysis Pursuant to Unilateral Conduct Laws [ICN PP RP], available at: http://www.internationalcompetitionnetwork.org/uploads/library/doc966.pdf, at page 6.
[31] See, [ICN PP RP] at page 5.
[32] Id.
[33] Draft Second Conduct Rule ¶¶5.12-5.14.
[34] Pacific Bell Telephone Co. v. linkLine Communications, Inc., 555 U.S. 438 (2009).
[35] Draft Second Conduct Rule ¶¶5.22-5.30.

Guideline notes, rebates are a normal commercial arrangement, and thus may be of concern only when used by an undertaking with a substantial degree of market power. Determining when such rebates have anticompetitive effects presents complex issues on which there is ongoing debate, and the Sections urge the Commission and Authority to approach such cases with great caution. It may not always be the case that such conduct constitutes an infringement of the Second Conduct Rule even in the presence of substantial market power.

With respect to the hypotheticals, it is unclear that Hypothetical Example 8 involves a business with substantial market power. Indeed, the hypothetical appears to infer the existence of a substantial degree of market power from the success of the undertaking's rebate arrangement. This is backwards. Accordingly, the Commission and Authority may wish to consider introducing additional facts in Hypothetical Example 8 to make clear the basis for the conclusion that LargeNoodle has a substantial degree of market power in rice noodles. Without substantial market power, none of the conduct described in Hypothetical Example 8 should be considered an infringement of the Second Conduct Rule.

4. Essential Facilities and Intellectual Property Rights

The Draft Second Conduct Rule Guideline recognizes that "[a]s a general matter, an undertaking, whether or not it has substantial market power, is free to decide with whom it will or will not do business".[36] However, the Draft Second Conduct Rule Guideline also provides that "[a] refusal to deal by an undertaking with substantial market power is likely to be abusive in very limited or exceptional circumstances"[37] and adopts in paragraphs 5.18 and 5.19 a form of the "essential facilities doctrine". "Given the importance of IPRs in encouraging creative activity and innovation," the Draft Second Conduct Rule Guideline tempers this approach in the case of intellectual property rights by considering "an undertaking's refusal to license an IPR as a violation of the Second Conduct Rule only in very exceptional circumstances".[38]

The Sections have substantial reservations about the essential facilities doctrine and commend the Commission and the Authority for adopting the doctrine only in exceptional circumstances. The essential facilities doctrine has rarely been used in the jurisdictions where it exists, and has never been used in the patent context anywhere in the world.[39] The United States

[36] Draft Second Conduct Rule Guideline ¶5.15.

[37] Id.

[38] Draft Second Conduct Rule Guideline ¶5.20.

[39] Leading antitrust scholar, Herbert Hovenkamp, has noted that "[r]egardless of the merits of the essential facilities doctrine in general, its application to intellectual property cases is particularly problematic". Herbert Hovenkamp, et al, IP AND ANTITRUST (Ch.13 *Unilateral Refusals to License*), 13-15 (2d ed. 2013). In the IPR context, the European experience offers a sense of the maximum extent of the use of such a doctrine, which has stopped short of patents. In *IMS Health GmbH & Co OHG v NDC Health GmbH & Co KG*, [2004] All ER (EC) 81 3 (2004), the European Court of Justice limited the doctrine to exceptional circumstances, in particular where access is essential to create a new product or service and alternatives are not feasible. More recently, the European Commission's Guidance in Its Enforcement Priorities in Applying Art. 102 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings ("Article 102 Guidance") states that an input is essential in a refusal to deal context when "there is no actual or potential substitute on which competitors in the downstream market could rely so as to counter – at least in the long-term – the negative consequences of the refusal". Communication from the Commission - Guidance on the Commission's enforcement priorities in applying Article 102 of the EC Treaty to abusive exclusionary conduct by

Supreme Court has never applied the doctrine and has observed that enforced sharing of assets is in "some tension with the underlying purpose of the antitrust laws".[40] While forced sharing of IPR (or any "facility") may seem to increase competition in the short run, because more suppliers could offer a downstream product, over the long run, the economy and consumer welfare suffer as fewer resources are invested in innovation.[41]

Conclusion

The Sections appreciate the opportunity to provide these comments and are available to provide additional comments or to participate in any further consultations that may be helpful to the Commission and Authority.

dominant undertakings, 2009 O.J. (C 45) 7, para. 83, *available at* http://ec.europa.eu/competition/antitrust/art82/. This Article 102 Guidance is consistent with the *IMS* decision.

[40] *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407-08 (2004). Broadly applied, the doctrine potentially supplants market economics and "requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are ill-suited". Id.

[41] See Richard J. Gilbert & Carl Shapiro, "An Economic Analysis of Unilateral Refusals to License Intellectual Property", 93 PROCEEDINGS OF THE NAT'L ACAD. OF SCIENCES OF THE U.S.A. 12749-12755 (1996), available at http://www.pnas.org/content/93/23/12749.full (showing that compulsory licensing may invite entry of inefficient firms and lower economic efficiency). Forced sharing lowers the value of the shared asset and can undermine the incentives for the asset owner to create the next technological breakthrough or for its rivals to develop a superior substitute to an existing industry-leading innovation. *Trinko*, 540 U.S. at 407-08.