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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**HEARING ON OLIGOPOLY MARKETS**

-- Note by BIAC --

**16-18 June 2015**

*This document reproduces a written contribution from BIAC submitted for Item 5 of the 123rd meeting of the OECD Competition Committee on 16-18 June 2015.*

*More documents related to this discussion can be found at [www.oecd.org/daf/competition/oligopoly-markets.htm](http://www.oecd.org/daf/competition/oligopoly-markets.htm).*

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## BIAC

1. The Business and Industry Advisory Committee (“BIAC”) to the OECD appreciates the opportunity to submit these comments to the OECD Competition Committee for its hearing on approaches to issues in oligopoly markets.

### 1. Introduction

2. It is well understood that markets in which prices are increased above a competitive level, or where output is reduced below a competitive level, can result in a loss of welfare. It is equally well understood that markets very frequently do not operate at competitive equilibrium. This result is common in markets in which no anticompetitive conduct occurs. An evaluation of oligopoly structures, therefore, should be conducted bearing in mind that “perfect competition” is a worthy aspiration, but often not an attainable one, regardless of the number or nature of the competitors in the market.

3. This hearing also raises an important question as to the scope and remit of competition agencies, and whether that remit includes the objective to drive markets toward perfect competition in the absence of anticompetitive conduct. Most, if not all, competition agencies are not assigned the responsibility for remediating distortions in competition that are *not* caused by a violation of the competition laws. This role is undertaken, in some cases, by agencies assigned with market regulation, which prevails chiefly in markets that historically were government owned or controlled and did not develop as competitive markets.

4. BIAC strongly encourages agencies to enforce the competition laws against market actors, including those in an oligopoly market structure, who violate the competition laws. We encourage agencies to investigate markets where there is evidence of a competition law violation. This includes the rigorous use of laws against price fixing, customer and market allocation, bid rigging, and other offenses which occur most often in oligopoly market structures and unquestionably harm consumers. This enforcement may properly extend, at times under different legal or evidentiary standards, to less “naked” conduct, including the improper sharing of highly sensitive information, invitations to collude, interlocking directorates, and other highly suspect conduct that may not rise to the level of an illegal agreement but may still have direct competitive harm.

5. At the same time, we express concern about efforts to initiate investigations in markets that are perceived to be operating sub-optimally absent any evidence of anticompetitive acts by the competitors in the market. In BIAC’s view, investigations of markets by enforcement agencies should be based on sound economic and factual evidence that provides a strong indication that competitors have undertaken anticompetitive actions beyond mere strategic interdependence. For reasons discussed below, BIAC does not believe that this is an appropriate or efficient use of agency resources, is not likely to result in sustainable outcomes, and imposes significant costs on industry that often are unjustified.

### 2. Oligopoly Structures Cannot Be Presumed To Be Anticompetitive

6. The thesis of this hearing appears to assume that markets with a small number of competitors and high barriers to entry naturally result in tacit or express collusion among competitors resulting in supracompetitive pricing to the detriment of consumers. However, markets with a smaller

number of large competitors, each of whom has the economies of scale and scope to attain a high level of operational efficiency and invest in innovation, also can present an environment for the *most* competitive of markets. Naturally, competition enforcement authorities should be concerned about anticompetitive behavior in oligopolistic markets, but there should be no presumption about the competitiveness of markets based merely on the number of competitors.

7. Oligopolies also can create procompetitive effects or demonstrate the existence of a competitive market. “[L]arge oligopoly firms achieve economies of scale and can support widespread research activities essential for maximum industrial progress in oligopoly markets where technology is fluid; that oligopoly prevents ruinous competition; and finally that the possibility of oligopoly firm growth with consequent high profits is a necessary incentive to entrepreneurship, which among other things makes possible the raising of the enormous quantities of capital required by modern industry. It has been suggested that greater price rigidity in oligopoly markets may be offset by greater incentive for product innovations that cannot be readily matched.”<sup>1</sup>

8. Because firms within an oligopoly must consider rival firms’ behavior to succeed, economic theory assumes that firms in an oligopoly perceive this independency, leading to the potential for strategic coordination and collusion. However, it is not inevitable that oligopolists will charge supra-competitive prices, reduce outputs, and harm consumer welfare. “In calculating its most profitable price and output, the oligopolist cannot ignore the fact that if it chooses a price higher than the competitive level, rivals can undercut its price and encroach upon its market share, thereby rendering the initial price increase unprofitable.”<sup>2</sup>

9. There are strong private incentives for a firm to deviate from any coordinated scheme or price increase imposed by other firms. A firm may find it profitable and thus desirable to offer a lower price to expand its own sales. This is particularly true in dynamic markets with frequent product introductions or innovation, markets with large customers, and markets involving “lumpy” demand.

10. “In today’s economy, many oligopolistic firms wield innovation as their main battle weapon, using it to wage both offensive and defensive campaigns against competitors. The result is precisely analogous to an arms race, in which two countries, each fearing an attack from the other, feel it is necessary to match the other country’s military spending. Similarly, two competing firms, each fearing the other will outspend it in acquiring the battle weapons of its industry, are driven to conclude that . . . their very existence depends on matching their rival’s effort and spending on the innovation process. Because these giant warring firms do not dare to relax their innovation activities, a constant stream of innovations can be expected to appear in the economies in which they operate.”<sup>3</sup>

11. Economists also observe that oligopolies favor innovation particularly in technology markets.<sup>4</sup> This is observed in both “neck-to-neck” (“NN”) and “leader-laggard” (“LL”) markets in intermediate situations, e.g., oligopoly markets, where both NN and LL industries have high incentives to innovate, resulting in markets that are more favorable to competition than market structures with more or less competition.<sup>5</sup>

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<sup>1</sup> Joseph Brodley, *Oligopoly Power Under the Sherman and Clayton Acts—From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285, 292 (1966-67).

<sup>2</sup> George Hay, *Oligopoly, Shared Monopoly and Antitrust Law*, 67 CORNELL L. REV. 438, 444 (1981-82).

<sup>3</sup> WILLIAM J. BAUMOL, *THE MICROTHEORY OF INNOVATIVE ENTREPRENEURSHIP* (2010).

<sup>4</sup> Philippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith & Peter Howitt, *Competition and Innovation: an Inverted-U Relationship*, 120 Q. J. ECON. 701 (2005).

<sup>5</sup> The literature has examined two types of situations regarding technology: 1) in neck-to-neck (NN) markets, where firms are equal in their technology; and 2) in Leaders-Laggards markets (LL), where some firms have superior technology. In the overall economy, if the degree of competition is low,

12. Certain practices that are sometimes condemned as facilitating practices also can serve procompetitive purposes, as well as anticompetitive purposes. “Advance announcements of price increases, for example, can benefit customers in their business planning by permitting them to place new orders before price increases are implemented or simply plan their business activity more coherently.”<sup>6</sup> Such practices should be closely observed by competition authorities, but should not be presumed to be anticompetitive.

### **3. Experience With Dominant Firms Instructs That Oligopoly Enforcement Should Require Exclusionary Behavior**

13. In considering the appropriate approach to addressing oligopolies, several lessons may be drawn from the enforcement of competition laws against dominant firms. At the pinnacle of coordination, an oligopoly can harm competition no more than a monopoly. In other words, the worst harm that an oligopoly can inflict upon a market is no more harm than a pure monopoly.

14. Under the laws of most jurisdictions, including the U.S. and EU, as well as other jurisdictions whose laws are patterned thereon, merely holding a dominant position is not considered a violation of the competition laws. Only when a dominant firm undertakes exclusionary conduct that harms competition are the laws deemed to be violated.

15. The laws of the EC also permit enforcement for exploitative abuses by a dominant firm. However, it is well recognized that exploitative abuses are difficult to recognize and may be a challenge to remedy. Commissioner Almunia noted that “the number of exploitative pricing cases in the EU has been relatively modest,” further explaining that “[i]f firms anticipate that a competition authority is ready to cap their prices when they are successful and earn high profits, their incentive to invest and innovate may be affected.”<sup>7</sup>

16. Dr. Röller has added to this explanation: “The above considerations suggest that both pro- and anticompetitive behavior involve exploitation. Since the goal of antitrust is to discriminate between pro- and anticompetitive conduct, it follows that the mere existence of exploitative behaviour is insufficient to identify anticompetitive practices. By contrast, the existence of exclusionary practices does provide a sound basis for identifying anticompetitive behaviour. As a result, one might conclude that it is indeed solely exclusionary conduct that antitrust should focus on.”<sup>8</sup> Perhaps for these reasons, the Commission rarely has enforced Article 102 on the basis of purely exploitative conduct.<sup>9</sup>

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firms in NN industries innovate less (and thus stay NN), the LL firms innovate more, resulting in LL sectors becoming NN. So, economies with less competition produce more NN markets. Since on these markets a low degree of competition induces less innovation, the level of innovation in the whole economy is slow. If there is a high degree of competition, firms in NN industries innovate more, changing NN sectors into LL sectors. Since LL sectors innovate less, and these industries remain LL. This results in the economy becoming even more LL, and since in LL industries, more competition induces less innovation, the level of innovation is low. However, in intermediate situations, e.g., oligopoly markets, both NN and LL industries have high incentives to innovate, resulting in markets that are more favorable to competition than economies with more or less competition. This is why the relationship between competition and innovation has an inverted U shape.

<sup>6</sup> OECD, Competition Comm., Oligopoly, DAF/CLP(99)25 (1999), at 205, available at [www.oecd.org/daf/competition/1920526.pdf](http://www.oecd.org/daf/competition/1920526.pdf) [hereinafter OECD Oligopoly 1999].

<sup>7</sup> Joaquín Almunia, Vice President for Competition Policy, Eur. Comm’n, Competition in the Online World, Address Before the London School of Economics 7 (Nov. 11, 2013), available at [http://europa.eu/rapid/press-release\\_SPEECH-13-905\\_en.pdf](http://europa.eu/rapid/press-release_SPEECH-13-905_en.pdf).

<sup>8</sup> Lars-Hendrik Röller, Exploitative Abuses, in EUROPEAN COMPETITION LAW ANNUAL 2007: A REFORMED APPROACH TO ARTICLE 82 EC 525, 526 (Claus-Dieter Ehlermann & Mel Marquis eds., 2008).

<sup>9</sup> Jonathan B. Baker, Exclusion As A Core Competition Concern, 78 ANTITRUST L.J. 527, 533 n.24 (2013) (“[I]n the European approach to competition policy, a dominant firm can be found to have

17. Professor Whish has observed that parallel behavior is expected within oligopolies and therefore does not establish anticompetitive behavior in isolation. “Some would favor making any parallelism in price between oligopolists illegal. This however would be quite inappropriate: it would be absurd to forbid firms from behaving in a parallel manner if this is an inevitable consequence of the structure of the market. To put the point another way, it would be strange indeed if competition law were to mandate that firms should behave irrationally, by not acting in parallel, in order to avoid being found to have infringed competition law.”<sup>10</sup>

18. Professor Baker has agreed: “Accepting this result by finding agreement whenever oligopolists price in parallel would lead the law into a hopeless swamp. The reason, and this is my second point, is that it leaves the courts without a remedy. Supposing parallel behavior alone were considered illegal, there would be nothing practical that a court could order the parties to do to correct it. If agreement is evidenced by something beyond merely parallel price behavior, then a court can in principle enjoin that extra ‘something.’ But if that something is absent, the only remedy is judicial price regulation, a complete non-starter. That is why, to paraphrase the Supreme Court, conscious parallelism has not read ‘agreement’ out of the Sherman Act.”<sup>11</sup>

19. “[F]orcing an oligopolist to price as if its market were perfectly competitive would (1) require it to act irrationally given its circumstances and (2) involve the antitrust court in price control, for which it is not suited. Further, (3) it would also treat the oligopolist more stringently than the monopolist, which would not make sense . . . . Absent collusion of the usual sort, lawful oligopolists—those who have obtained their market position because of economies of scale, patents, or other competitive superiority—should be able, like the monopolist, to take advantage of the natural consequences of their position.”<sup>12</sup>

20. This rationale is consistent with legal precedent, including the U.S. Supreme Court decision in *Matsushita* which recognized that “conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone,”<sup>13</sup> constitute an antitrust violation. Instead, a violation requires evidence that “tends to exclude the possibility that the alleged co-conspirators acted independently.”<sup>14</sup>

21. This is not to say that strategic exploitation of market power is desirable, merely that it is an inevitable part of the competitive fabric. And given that strategic exploitation by an oligopoly, by definition, cannot exceed that of a monopoly, it becomes difficult to find a basis on which to increase enforcement against oligopolies purely on the basis of exploitation and absent any conduct—such as hard core agreements—that might mimic the exclusionary conduct requirement of a dominant firm offence.

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abused its position through exploitative offenses such as charging higher prices, though such cases are rare.”).

<sup>10</sup> DAVID BAILEY & RICHARD WHISH, *COMPETITION LAW* 546 (6th ed., 2009).

<sup>11</sup> Jonathan Baker, *Horizontal Price-Fixing in Cyberspace*, Address Before the 1996 Antitrust Conference: Antitrust Issues in Today's Economy (Mar. 7, 1996), available at [www.ftc.gov/public-statements/1996/03/horizontal-price-fixing-cyberspace](http://www.ftc.gov/public-statements/1996/03/horizontal-price-fixing-cyberspace).

<sup>12</sup> Jason Gudofsky, Evangelia Litsa Kriaris & Lucian Vital, *Abuse of Joint Dominance: Is the Cure Worse than the Disease?*, Address Before the Canadian Bar Ass'n 2010 Annual Competition Law Conference (Sept. 30 – Oct. 1, 2010), available at [www.cba.org/cba/cle/pdf/comp10\\_Gudofsky\\_paper.pdf](http://www.cba.org/cba/cle/pdf/comp10_Gudofsky_paper.pdf), at 25.

<sup>13</sup> *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

<sup>14</sup> *Id.*

#### **4. Agencies Have Effective Tools for Addressing Competition Laws against Oligopolists**

22. Competition agencies have numerous tools at their disposal to address violations of competition laws undertaken or attempted by oligopolists. Firstly, all OECD member jurisdictions have merger control laws, most of them suspensive, that regulate and prevent mergers that would lead to market structures in which oligopolistic market participants effectively could tacitly collude either under the analysis of coordinated effects or joint dominance. These merger laws are rigorously enforced and are quite effective at preventing oligopolies likely to lead to supra-competitive pricing.

23. Cartel laws are an extremely effective tool at policing anticompetitive conduct among oligopolists. The enhanced use of leniency programs has proven extraordinarily effective at destabilizing cartels and bringing an end to the most egregious of competition law violations.

24. Other “less naked” offenses are effectively addressed by TFEU Article 101, §5 of the FTC Act, member state unfair trade acts and a host of other “catch-all” laws that can be used to deter inappropriate behavior.

25. Interlocking directorates are unlawful under §8 of the Clayton Act and may fall within the scope of the laws of the European Union.<sup>15</sup> These too help to limit the potential for unlawful strategic coordination among oligopolistic firms.

26. BIAC is of the view that this arsenal of competition law weaponry should be primary in the efforts of competition agencies to enforce against the potential harms of oligopolies who engage in actual or attempted anticompetitive acts.

#### **5. Market Studies Are Costly and Should Be Limited**

27. It is well recognized that market studies and investigations are costly and time-consuming. The ICN has noted the high costs to agencies of conducting such studies: “Market studies can demand large expenditures of time and resources, typically ranging from two to three full time staff to, in exceptional cases, as many as 25 experts and other employees. Likewise, most market studies require a time commitment of at least six months to one year, with some studies lasting as long as two years.”<sup>16</sup>

28. Commenters have observed that there are potential disadvantages and costs associated with market investigations and sector inquiries for both the companies in the market or sector under review and the authorities which lead the investigations.<sup>17</sup> “The opportunity cost in this case arises from the time and energy spent (among other things) drafting questionnaires, filing in questionnaires, searching for relevant information, organizing hearings, attending hearings and lawyers’ costs. This point is obvious: market investigations and sector inquiries take up time and consume resources. Consequently they should be used sparingly and only when a clear objective is to be served, one that is plainly worth all of the potential effort and costs involved.”<sup>18</sup>

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<sup>15</sup> OECD, Competition Comm., Minority Shareholdings, DAF/COMP(2008)30 (2008), at 175-88, available at [www.oecd.org/daf/competition/mergers/41774055.pdf](http://www.oecd.org/daf/competition/mergers/41774055.pdf).

<sup>16</sup> INT’L COMPETITION NETWORK ADVOCACY WORKING GROUP, MARKET STUDIES GOOD PRACTICE HANDBOOK 15-16 (Apr. 2012), available at [www.internationalcompetitionnetwork.org/uploads/library/doc907.pdf](http://www.internationalcompetitionnetwork.org/uploads/library/doc907.pdf).

<sup>17</sup> Philip Marsden & Peter Whelan, When Markets Are Failing, Competition Law Insight: Antitrust Law and Policy in a Global Market, in COMPETITION L. INSIGHT 6, 8 (Jan. 16, 2007), available at [www.biccl.org/documents/178\\_clf\\_when\\_markets\\_are\\_failing\\_part\\_1\\_marsden\\_and\\_whelan\\_2007.pdf](http://www.biccl.org/documents/178_clf_when_markets_are_failing_part_1_marsden_and_whelan_2007.pdf).

<sup>18</sup> Id.

29. These investigations and studies are not only costly in terms of time and resources “but they can also have negative impact in terms of their effects on the reputation[s]”<sup>19</sup> of the companies that are being reviewed. The mere fact that a company is being investigated may cause consumers to assume that “something sinister is occurring in the market – for example, price collusion or an abuse of a dominant position.”<sup>20</sup>

30. In conducting its recent study of patent licensing under § 6(b) of the FTC Act, the Commission recognized that there would be costs to the subjects of the investigation.<sup>21</sup> The FTC went to great lengths to work with the parties under investigation to limit those costs. Nonetheless, the real costs to the parties involved are widely known to have exceeded FTC estimates. As acknowledged by one company in response to the FTC’s study, “While the Commission has substantially reduced the volume of documents that must be produced by respondents and raised its burden estimates, the Commission’s revised estimated hours burden (425-845 hours), cost burden (\$68,750-\$211,250), and estimate of capital or non-labor costs (\$500) continue to substantially underestimate the actual burden that will be imposed on PAE respondents.”<sup>22</sup>

31. There is also a fear that market investigations and studies may be “overused” and will become “an unrestrained alternative to enforcement of the competition law rules rather than as a valuable complement.”<sup>23</sup> “[M]arket investigations and sector inquiries should be seen as an instrument of last resort and only used in the most appropriate circumstances. Such tools are unquestionably doomed to failure if they are used in an unsuitable manner and for inappropriate reasons.”<sup>24</sup>

32. A comment by one observer perhaps sums it up best: “Market studies and investigations should not be used as a ‘fishing expedition’ for antitrust infringement.”<sup>25</sup>

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<sup>19</sup> Id.

<sup>20</sup> Id.

<sup>21</sup> The FTC estimated that approximately twenty-five PAE firms would each spend 425-845 hours and that approximately fifteen manufacturers and NPEs would each spend 275-565 hours. The FTC also assumed a mid-management level / outside legal counsel average rate of \$250/hour for all labor costs, meaning the labor costs per company may range between \$68,750 (275 hours × \$250/hour) and \$211,250 (845 hours × \$250/hour). Agency Information Collection Activities; Submission for OMB Review; Comment Request, 79 Fed. Reg. 28715, 29728-29 (May 19, 2014).

<sup>22</sup> Comments to the Federal Trade Commission Proposed Information and Document Requests Patent Assertion Entity (PAE) Report, Submitted by Intellectual Ventures (June 18, 2014), available at [www.ftc.gov/system/files/documents/public\\_comments/2014/06/00033-90500.pdf](http://www.ftc.gov/system/files/documents/public_comments/2014/06/00033-90500.pdf), at 11. Intellectual Ventures also noted that “[t]he expense incurred by IV responding to the Revised Requests would undoubtedly run to the millions of dollars. Responding to section C alone would likely require several hours per patent simply to provide the data and narrative responses required, even without considering the hours required to search for Reports relevant to each patent. Given IV’s portfolio of approximately 70,000 patents, responding just to section C would likely require more than 300,000 hours of work.” Id.

<sup>23</sup> Marsden & Whelan, *supra* note 17, at 8.

<sup>24</sup> Id.

<sup>25</sup> Linklaters LLP, Response by Linklaters LLP to the BIS Consultation “A competition Regime for Growth: A Consultation on Options for Reform,” June 21, 2011, available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/312068/L-O-competition-regime-for-growth.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/312068/L-O-competition-regime-for-growth.pdf), at 4.

## 6. Market Regulation Should Be Reserved For Extraordinary Circumstances

33. We note that some forms of market intervention in the name of market studies or attempts to address perceived market inefficiencies can resemble market regulation, which BIAC believes is not within the normal purview of competition authorities lacking the expertise of industry specialists. The inevitable result of such intervention is that price regulation substitutes the regulator's judgment for the mechanisms of the free market, inevitably leading to inefficient outcomes.<sup>26</sup>

34. BIAC believes that generalist regulatory intervention should be evaluated, decided and effectuated by a specialist regulatory agency charged with specific jurisdiction over such issues. Likewise, where the authority granted to a specialist regulatory agency is arguably broad enough to encompass competition concerns, the competition analysis should be ceded to the national competition authority, thereby allowing each agency to focus on its own core competencies.<sup>27</sup>

35. "Regulation imposes a particular course of conduct on an undertaking (dominant or non-dominant) on the theory that this will ensure the better development of competition. The reality of experience is that regulation becomes permanent, and that regulators may inadvertently handicap the market forces that they are trying to release. And as competition law is used in more novel and complex fields, it becomes difficult to say whether an intervention is meant to punish an identified abuse, or whether it aims instead to adjust the manner in which a market functions."<sup>28</sup> BIAC encourages competition regulators to resist the temptation to act as an industry regulator and to take action only where competition abuses, as measured by traditional standards, warrant intervention.<sup>29</sup>

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<sup>26</sup> OECD Oligopoly 1999, supra note 6, at 201.

<sup>27</sup> OECD, Global Forum on Competition, Competition Issues in Television and Broadcasting – Contribution from BIAC, DAF/COMP/GF/WD(2013)62 (Feb. 25, 2013), at ¶ 8, available at [www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD\(2013\)62&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD(2013)62&docLanguage=En).

<sup>28</sup> Ian S. Forrester, QC, Sector-specific price regulation or antitrust regulation – A plague on both your houses?, in EUROPEAN COMPETITION LAW ANNUAL 2007: A REFORMED APPROACH TO ARTICLE 82 EC 547, 565 (Claus-Dieter Ehlermann & Mel Marquis eds., 2008).

<sup>29</sup> OECD, Global Forum on Competition, Competition Issues in Television and Broadcasting – Contribution from BIAC, DAF/COMP/GF/WD(2013)62 (Feb. 25, 2013), at ¶ 43, available at [www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD\(2013\)62&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD(2013)62&docLanguage=En).