Managing Antitrust Risks

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Antitrust laws aim to protect economic freedom and opportunity and provide a better deal to the customers by promoting competition in the market place. The basic premise of anti-trust laws is that increased competition leads to lower prices, better quality and more choice for customers. Anti-trust laws also aim at creating a level playing field and encouraging new entrants into the industry.

Most countries have laws which prohibit restrictions on entry into specific industries or markets; price-fixing agreements; 'concerted practices' (whereby firms rig markets through their behavior but without entering into explicit agreements); exclusive distribution arrangements; and mergers and acquisitions that result in excessive market power. Different countries have put in place various measures to restrict anti-competitive practices:

- Many countries are giving their anti-trust authorities the power to dismember quasi-monopoly groupings with retrospective effect.
- Some countries have imposed specific quantified limits on business activity. French law, for example, prohibits any 'concentration' of businesses that controls more than 25 percent of the sales, purchases or other transactions in a given market. A concentration is defined as any situation in which a company or group can directly or indirectly exercise a decisive influence on another company.
- In some countries, there is an automatic investigation of any company or group with a market share exceeding what is considered reasonable.
- In many developed countries, all large-scale distribution agreements must be approved by the anti-trust authorities.

In this article, we attempt to understand the important competition laws that exist in different parts of the world and their implications for corporations.

Basic Concepts of Fair Competition

Competition laws define market power, market dominance, and abuse of a dominant market position. 'Market power' means the ability of businesses to increase significantly the price of their output without a decline in sales. Abuse of a dominant position occurs when a firm actually raises its price to unjustifiably high levels. Market power may not necessarily damage economic welfare especially if it off-sets other distortions in the economic structure of a country, e.g., if a monopoly invests its excessive profits in a nation where the capital markets cannot provide the funds necessary for major new ventures.

Assessment of market power also requires the definition of a 'relevant market', since a given level of sales will represent a larger proportion of a narrowly demarcated market than of one that is liberally defined. This has been an important issue in the Microsoft anti-trust case. Practical problems with the actual measurement of a relevant market include:

a. defining 'substitutable products'

b. separating price movements attributable to market power from those due to inflation.

c. uncertainty about the entry of new firms into the market.

Different countries deal with the issue of relevant market differently. The US, for example, describes a relevant market as 'the narrowest combination of a set of products and a geographic area such that if all the production capacity in that product set were owned by a single firm, that could profitably raise price by (usually) at least five percent above a benchmark price for a significant

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Intel: Avoiding Anti-trust Litigation

One company which has successfully handled potential anti-trust problems and avoided adverse publicity and costly lawsuits is Intel. Much of this success has been attributed to Intel's legendary former CEO, Andy Grove.

As Intel's growth accelerated in the mid-1980s, fuelled by the PC revolution, Grove decided to take a proactive approach towards potential anti-trust issues. Realizing that the dividing line between acceptable and unacceptable conduct was thin, Intel decided to take necessary precautions. Strict instructions were given to employees not to discuss product and pricing strategies with competitors. Almost the entire executive staff was trained by the legal department, which started the practice of auditing employee files on a random basis. Whenever irregularities were found, the legal department investigated the source, suggested a remedy and updated its training program to prevent similar problems from recurring in the future. Intel also began to conduct mock anti-trust raids and cross-examine senior executives in front of the other staff.

The US Federal Trade Commission (FTC) reviewed Intel's activities twice during the 1990s but stopped short of taking any action. Though Intel signed a consent decree in 1999 about the use of its intellectual property. But Intel has by and large avoided long legal entanglements that other companies like IBM and Microsoft have found themselves in, over the past decade.

Despite all these efforts, Intel cannot afford to be complacent. Due to its size, strength and large market share, regulators always keep the company under close watch. In 1997, three computer companies, COMPAQ, Digital Equipment and Intergraph alleged that Intel had withdrawn from them technical information and access to technology. The FTC pressed anti-trust charges against Intel in June 1998, on the grounds that the company had used monopoly power to bully customers (with whom it had patent disputes), by withholding crucial information from them. Ordinarily, a company could choose not to deal with any customer, but the rules were different if a company was a monopoly. The FTC also started investigations into, whether Intel's marketing subsidies to PC makers had given it an unfair advantage over its rivals. Another issue was whether Intel had unfairly used its market power in microprocessors to move into markets for other components.

Intel argued that it had the right to choose its business partners, and that it was merely using its intellectual property as a defensive competitive weapon. The FTC argued that Intel was abusing its monopoly power, and had to share details of its new products because computer-makers could not stay in business without the information. Intel handled its public relations well and many analysts felt the FTC would not be able to gather enough evidence to substantiate its charges. Their prediction turned out to be right.

The settlement on March 15, 1999 barred Intel from denying technical information to a company, with which it had a patent dispute. However, Intel could deny information to companies that took other aggressive actions against it. The ruling carefully avoided the controversial issues behind the case, whether Intel had a monopoly in the market for PC microprocessors, and whether its behavior towards the three companies was illegal. Grove's successor, Craig Barrett expressed happiness at the settlement.

Even though Intel made some concessions, it wriggled out of a tight corner. By avoiding the risk of being formally labeled a monopoly, it avoided costly and damaging private lawsuits. Had it been attacked in the court room by hostile witnesses, Intel would have been at the receiving end. Quite clearly, by avoiding protracted litigation, Intel has proved that, it is far better at managing anti-trust issues than Microsoft.

non-transitory period[1]. In contrast, the European Commission defines the relevant market very broadly, as the market for "those products which are regarded as interchangeable or substitutable by the consumer, by reason of the products" characteristics and their intended use. This allows the Commission to be as flexible as possible in its interpretation.

Intuitively, the number of firms within a specific industry sector and the market shares of each of these companies should indicate whether it is a case of market dominance. While the existence of a large number of competing firms with an even distribution of market shares gives prima facie evidence of the absence of a dominant position, a small number of competing firms with a few having large market shares does not necessarily imply dominance. Firms may have captured a large market share unintentionally, with competitors having the potential to increase their (initially low) market shares with a little more investment and effort.

Competition Laws in the US

Some of the important antitrust statutes in the US are briefly covered below:

i. Sherman Anti-trust Act

American competition laws originated in the Sherman Act of 1890 that prohibited monopolies. The act, named after Senator John Sherman, from Ohio and who was earlier a Treasury Secretary, was drafted to rein in business tycoons like

[1] *US Department of Justice Merger guidelines, 1992.*

GE - Honeywell Deal Falls Apart

In October 2000, General Electric (GE) finalized a deal to acquire Honeywell for $40 bn. Together the two companies offered a wide product range including aero engines, avionics products, small jet engines, under carriages, auxiliary units, brakes and leasing and other financial services. Legendary CEO Jack Welch announced that he was postponing his retirement plans to see the deal through. Welch had no doubts whatsoever about getting regulatory approval.

Trouble started when the European Commission (EC) announced on February 27, 2001 that it would conduct a full scale anti-trust enquiry in view of the merged entity's tremendous market power. Even though the aircraft engine market was quite competitive, with players like Rolls-Royce and Pratt & Whitney, the EC felt that GE's dominance could hurt competition in the long-run and even lead to the exit of some players from the industry. Moreover, competitors who offered only engines would find themselves ill equipped to compete with GE's bundled products.

The EC competition commissioner, Mario Monti stipulated tough conditions including divestment of Honeywell's avionics unit and dilution of GE's stake in GE Capital. While GE had promised that its finance subsidiary, one of the two leading aircraft finance companies in the world, would behave responsibly, the EC insisted on a spin-off. While GE was prepared to sell a part of the avionics business, the EC demanded much more.

On May 8, 2001, Welch admitted that he had underestimated the difficulty in getting approval from the European authorities. On June 14, after a meeting in Brussels, Welch announced that the EC's conditions were so restrictive that it would be very difficult for the deal to go through. On July 3, Monti confirmed that he would block the deal.

Following the failure of the deal to come through, Honeywell CEO, Michael Bonsignore lost his job. Honeywell's operational difficulties became more due to the attention drawn to the merger. It was left regretting its decision not to go ahead with an earlier, less ambitious plan to merge with United Technologies. GE had made a rival bid to steal the deal from United Technologies at the last moment.

John D Rockefeller. But the act did not have much impact on American business, until it was used by President Roosevelt to break up monopolies in the oil and railroad industries.

The Sherman Act marked the culmination of public concern about violation of free market principles by price-fixing cartels, the absence of competition in shipping and above all, the activities of the Standard Oil Company. The Act outlawed actions that restrained trade. (Many of these actions would not be regarded as controversial today). It also vaguely targeted companies that attempted to "monopolize" any part of trade and commerce. But it did not spell out when the legitimate pursuit of profits became an illegitimate monopoly.

Currently under the Act, every contract, combination or conspiracy in restraint of trade or commerce is considered illegal. Individuals who attempt to monopolise, combine or conspire with anyone to monopolise trade can be convicted. The Sherman Act covers agreements among competitors to fix prices, rig bids and share business. A monopoly is considered to be unfair or unlawful if it has become the only supplier by suppressing competition. Only the US Department of Justice (DoJ)can bring criminal prosecution under the Sherman Act.

ii. Wilson Tariff Act

This applies to importers of goods into the US who restrain trade and make unfair attempts to increase prices.

iii. Clayton Act

This was passed in 1914 and significantly amended in 1950. It prohibits mergers and acquisitions that are likely to lessen competition. Acquisitions above a certain size must be notified to the anti-trust authorities. The Clayton Act considers price discrimination by companies across customers where such discrimination will create a monopoly or destroy or limit competition. It also examines attempts by companies to appoint exclusive dealers, i.e., dealers who stock only their goods and not those of competitors. It also imposes restrictions on multiple directorships that may lead to collusion and lesser competition.

iv. International Anti-trust Enforcement Act

This empowers the Attorney General of the US and the Federal Trade Commission (FTC) to assist foreign anti-trust authorities and enforce foreign anti-trust laws wherever applicable.

v. ***Federal Trade Commission Act***

This prohibits unfair methods of competition in inter-state commerce. The Act does not however, carry any criminal penalties. The FTC has been set-up to enforce the Act.

Implementation of Anti-trust Laws in the US

US anti-trust laws can be enforced in three ways:

- Criminal or civil enforcement actions brought by the DoJ.
- Civil enforcement actions brought by the FTC.
- Lawsuits brought by private parties.

DoJ attorneys work closely with the Federal Bureau of Investigation (FBI) and other investigative agencies to collect evidence. The DoJ can resort to court-authorized searches of a business, and monitor phone calls using secret listening devices. Follow on civil suits by state attorney generals and groups of customers are also encouraged.

The DoJ is particularly severe on bid rigging and price fixing. These are considered to be the worst forms of anti-competitive practices. In price fixing, two companies agree to raise prices or not to sell below a certain price. Bid rigging takes place when two or more companies pretend to be competitors but secretly agree not to bid against each other in tenders or agree on the level of their individual bids. DoJ has filed criminal cases against many milk and dairy product suppliers for bid rigging. The Anti-trust division noticed in the early 1980s, attempts to rig bids for supply of milk and dairy products to public schools, districts and other public institutions. The division began an investigation throughout the state of Florida and subsequently in other states in 1986. Subsequently, it filed several cases and imposed fines exceeding $70 mn.

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Under anti-trust provisions, the US Federal Government can break up a company, regulate its conduct, impose large fines/penalties and even imprison senior executives. Even if the company wins in the court, it would lose severely in terms of wasted resources, distracted management and a tarnished image. Some of the notable anti-trust cases have been AT&T, IBM and Microsoft. The DoJ won the case against AT&T and forced the company to split into so-called “Baby Bells” and “Ma Bell” (AT&T) the long-distance company. Against, IBM, the DoJ dropped proceedings after a protracted period of litigation. The Microsoft anti-trust case which started in 1998 has just reached the concluding phase.

In the 1970s, many economists protested against the overly legalistic approach of the authorities. Many anti-trust actions, it was shown, had harmed American competitiveness and consumers’ interests, by undermining the efficiency of companies and the market mechanism. An indication that the government’s stand was changing came in 1982, when William Baxter, Ronald Reagan’s Anti-trust Chief, dropped the government’s investigation into IBM.

Anti-trust investigations in recent times have been much more professional and business like. In 1997, when Staples and Office Depot, two office supplies retail chains announced plans to merge, the FTC began investigations. It found that Staples’ prices were lower in cities where Office Depot also had a store compared to where it had none. Concluding that the deal would allow Staples to raise prices, the FTC blocked the merger.

In 1995, when America’s third-largest wholesale baker, Interstate Bakeries announced plans to acquire Continental Baking, the government collected various types of retail store data for different types of bread. Detailed mathematical analysis by DoJ’s economists revealed that the price of Interstate’s sliced white breads affected the sale of Continental’s Wonder Bread. Consequently, the authorities raised objections and Interstate had to sell off some of its bakeries and brands to get the approval.

Competition Laws in the European Union

Articles 85 and 86 of the Treaty of Rome which created the European Economic Community form the basis for competition policy in Western Europe.

Regulation 4064/89 (1990) establishes the commission's jurisdiction over mergers and acquisitions. The Treaty of Rome expressly forbids restrictive trade practices and monopolies which may interfere with trade within or between countries.

The primary goal of competition policies in Europe does not seem to be to encourage competition, as in the US. European politicians have traditionally believed in the social market mechanism. They have all along felt that market forces are not enough for equitable allocation of resources. The main goal in Europe, though not explicitly stated, is to encourage the formation of pan European corporate entities. The Commission recognizes the need for Europe to possess large companies with economies of scale, that can compete effectively in world markets, especially with American corporations. Thus, in recent years, new regulations have been introduced which allow cross-frontier amalgamations. The authorities also encourage large firms to organize themselves on a Europe-wide basis. (Airbus is a good example). Taxes which discriminate against cross-frontier mergers (compared to mergers within a single country) have been largely abolished and many legal barriers to international amalgamations of EU firms have been removed.

A dominant position is defined as one which enables an enterprise to limit competition by operating independently to its competitors and customers

EU anti-trust regulations are wide ranging, covering horizontal and vertical integration, market sharing agreements, retailing arrangements (Exclusive dealerships are not allowed), joint ventures, patents and trademarks, and franchise agreements. These regulations apply to services as well as goods.

Article 85 prohibits trade practices which prevent, restrict or distort competition. It primarily focuses on horizontal arrangements. Article 86 prohibits firms which occupy a dominant position in an EU market from abusing that position. It focusses on vertical arrangements. A dominant position is defined as one which enables an enterprise to limit competition by operating independently to its competitors and customers. (There have been cases where firms have increased their market shares by taking over competitors, or gained control over the supply of raw materials and then cut-off supplies to competing firms). The Treaty of Rome defines the following business practices as abuses of a dominant position:

- Imposition of unfair prices for purchase of raw materials or for sale of final goods.
- Restrictions on production.
- Restrictions on distribution.
- Holding back technological development.
- Charging different prices to different consumers.

The Commission does not regard the following activities as violating Articles 85 and 86:

- Exchange of opinion or experience.
- Joint market research.
- Joint collection of trade and market statistics.
- Co-operation in the preparation of accounts, or in tax matters.
- Provision of trade credit.
- Joint debt collection.

Articles 85 and 86 are directly enforceable in each country. Mergers which have an impact on several European countries are investigated by the (European Commission) EC. Other concentrations are typically examined by member states. However, there are exceptions. At the EU level, the Commission will investigate a complaint registered under either of these Articles and, if proven, will ask the firm involved to alter its behavior. If it refuses, the Commission will issue a formal warning and if this fails to have the desired impact, the Commission will approach the European Court for a ruling. However, in the end, firms cannot be physically dismembered, only fined heavily.

Article 85 and 86 also incorporate a negative clearance doctrine. Firms can notify the commission that a concentration or a transaction might violate Article 85/86. In this way, firms can draw attention to an agreement that would otherwise escape the eyes of the commission. Companies that are merging can protect themselves from this time consuming and risky process by obtaining a letter of comfort from the commission. Such a letter though not legally binding is a clear indication that the commission is unlikely to nullify the transaction at a later date.

Competition Laws in Japan

Prior to American occupation, Japan did not have any formal competition policy. In 1946, Zaibatsu[2] assets were frozen. The Deconcentration law of 1947 split large, monopolies into smaller companies. The Anti-Monopoly Law which was passed in 1942 introduced policies which were stricter than the Sherman, Clayton and FTC Acts in the US. Cartels and monopolies were declared illegal. The Japan Fair Trade Commission (JFTC) was given the power to dissolve or break-up dominant firms. Many of these stringent provisions were diluted after the occupation forces left Japan in 1952. The Ministry of International Trade and Industry (MITI) was given powers to encourage cartels where necessary. During the 1950s and 1960s, MITI made full use of its powers.

A 1977 amendment to the Anti-Monopoly Law tried to strengthen the provisions of the competition policy. However, as of 1991, JFTC had initiated only six cases involving monopolization, the most recent one going back to 1972. MITI and JFTC disagree over the role of cartels. MITI is more powerful and even today, it is common to see cartels and unregulated keiretsu arrangements in Japan.

Unlike in the US, private enforcement of anti-monopoly laws is virtually non-existent in Japan. And the government has traditionally been more concerned with international competitiveness than competition at home. Also, as mentioned earlier, JFTC is not as powerful as MITI. In the 1980s, JFTC's decision to prosecute the directors of major oil refiners, who had formed a cartel was overruled by the Tokyo High Court on the grounds that they were operating under MITI's instructions. The Supreme Court declared the arrangement to be illegal but did not categorically state that the anti- monopoly laws took precedence over the administrative guidance issued by MITI.

The following are some of the anti-monopoly provisions currently in force in Japan:

- punitive fines to deter collusive conduct.
- reinstatement of JFTC responsibility to break-up large corporations.
- criminal penalties for violation of anti-monopoly laws.
- price reporting systems to curb unfair practices when many suppliers increase prices simultaneously.

Competition Laws in Emerging Markets

In China, tight state control of economic development and the absence of major, privately owned companies have obviated the need for competition laws at least till recently. India's Monopoly and Restrictive Trade Practices Act has been largely modelled after US and British laws. However, anti-trust enforcement does not seem to be high on the list of priorities of the Indian Government. Many mergers are taking place, without even a semblance of objection from the anti-trust authorities. Recently, however, the Government has proposed a competition law. Mexico also has various competition laws but enforcement has been weak, with no single dedicated agency to curb anti-competitive conduct. Posco and Samsung were recently fined for anti-competitive practices in Korea, which is strengthening its anti-trust institutional framework. South Africa is also putting in place competition laws.

Indonesia passed its first competition law in 1999. Malaysia has been drafting competition laws in recent times. Most Asian countries have given a low priority to anti-trust issues. Even the advanced Asian economies like Hong Kong and Singapore do not have adequate legal mechanisms against cartels. Indeed, many sectors of Singapore's economy are dominated by government monopolies.

Concluding Notes

As the regulatory network gets stronger, companies need to be vigilant about anti-trust issues. A wrong understanding or interpretation of the legislation involved can land a company in serious problems. Ultimately, complying with anti-trust laws is about obeying the law in letter and spirit. So, managing anti-trust issues must be a deliberate, planned process rather than *ad hoc* knee-jerk reactions to moves made by government regulators.■

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[2] Zaibatsu is the term for large Japanese conglomerates, typically trading houses.