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This contribution is submitted by the United States under Session IV of the Global Forum on Competition to be held on 5-6 December 2019.

More documentation related to this discussion can be found at: [oe.cd/cmkt](http://oe.cd/cmkt).

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## *Competition for-the-market*

### **– Contribution from the United States –**

#### **1. Introduction**

1. The Roundtable on “Competition-for-the-Market” has identified four categories where firms compete not for market share but instead to serve an entire market: (a) natural “monopolies” involving large economies of scale, (b) publicly-funded “monopolies” for services which would not otherwise be meaningfully provided to the market, (c) legally-protected “monopolies” such as those involving intellectual property designed to incentivize innovation, and (d) platform “monopolies” such as digital platforms with powerful direct or cross-platform network effects that generate increasing value from scale or scope. The U.S. Antitrust Agencies recognize that firms can compete for the market in scenarios that are not covered by these four categories. The OECD background note states that it will leave platform markets “for a future discussion.”<sup>1</sup> Because the OECD requests comment on only three of these four categories, we limit our views to those three categories, and do not address other scenarios in which competition for the market can occur. The U.S. Antitrust Agencies also provide a note of caution, elaborated upon further below, that the term “monopoly” should only be applied after an analysis of a relevant market. For example, intellectual property rights do not necessarily result in market power.

2. This submission illustrates, with examples from U.S. experience in enforcement and advocacy, how general competition principles can inform an appropriate evaluation of mergers, firm conduct, and government interventions in these categories of competition for the market. Under general principles, competition laws should not condemn “growth or development as a consequence of a superior product, business acumen, or historic accident.”<sup>2</sup> Rather, the experience of the U.S. Antitrust Agencies and economic learning teaches that the potential for monopolies to be achieved in this manner creates important dynamic incentives for firms to promote economic welfare and improve the price and quality of the goods and services they offer through competition. Instead, the U.S. antitrust laws prohibit firms from taking anticompetitive actions that foreclose competition or otherwise interfere with the competitive process.

3. A concern, though, is that once established a monopolist may exercise its market power without the continual discipline of the market to innovate and improve the quality and lower the cost of goods and services it offers. Competition principles can be useful to assess whether this concern applies in a particular context, to what degree, and what additional policy response may be appropriate—if any—given the available tradeoffs and alternatives.

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<sup>1</sup> Background Note by the OECD Secretariat on Competition for-the-Market ¶ 39 (Oct. 22, 2019).

<sup>2</sup> *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966).

## 2. Natural “Monopolies”

4. Natural “monopolies” occur in markets characterized by substantial economies of scale and scope relative to consumer demand. Under these conditions, it may be most efficient to have one firm supply the market. This does not mean there is no role for competition. As U.S. courts have stated, “competition for a natural monopoly can be just as beneficial to consumers as competition within an ordinary market.”<sup>3</sup>

5. Antitrust enforcement must then take this competition into consideration, and the U.S. Antitrust Agencies are vigilant in their review of mergers and potentially anticompetitive conduct in such industries, including electric transmission and natural gas pipeline construction. For example, a merger of the likely number one and number two bidders to build electric transmission projects may raise concerns about possible unilateral effects, and the merger of two of a small number of bidders may raise concerns under a coordinated effects theory. Likewise, unlawful exclusionary conduct by an incumbent natural monopolist can harm consumers, for example, by excluding rivals seeking to introduce a superior technology that may displace the monopolist’s product or open the market for competition.

6. In addition, U.S. experience has found that competition in markets traditionally characterized as natural monopolies can be introduced or increased, sometimes with support from appropriate policies. The electric grid, which traditionally has been described as a natural monopoly, is illustrative.<sup>4</sup> In recent decades, the U.S. Federal Energy Regulatory Commission (“FERC”) has been facilitating competition in wholesale electricity markets and in transmission development. One FERC order, for example, unbundled wholesale generation and transmission services to provide competitive electricity generators with non-discriminatory access to the electricity grid.<sup>5</sup> Another FERC order encouraged the use of independent system operators or regional transmission organizations to coordinate planning, operation, and use of regional and interregional transmission systems in competitive markets for wholesale power.<sup>6</sup> In a third example, FERC facilitated competition to propose and develop electric transmission projects by requiring that transmission lines subject to regional cost allocation be awarded based on an evaluation and comparison of competing proposals and by removing federal rights of first refusal previously granted to local incumbents.<sup>7</sup>

<sup>3</sup> S.C. Pub. Serv. Auth. v. FERC, 762 F.3d 41, 68–69 (D.C. Cir. 2014) (quoting III PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW § 658b3 (3d ed. 2008)).

<sup>4</sup> E.g., Background Note by the OECD Secretariat on Competition for-the-Market ¶ 17 (Oct. 22, 2019).

<sup>5</sup> Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, 61 Fed. Reg. 21,540, at 21,552 (Apr. 24, 1996).

<sup>6</sup> Regional Transmission Organizations, 65 Fed. Reg. 810, at 811 (Dec. 20, 1999).

<sup>7</sup> Transmission Planning & Cost Allocation by Transmission Owning & Operating Pub. Utils., 136 FERC ¶ 61,051, at PP 313, 321, 326, 328, 330, 336 (2011) [hereinafter Order 1000].

7. The U.S. Antitrust Agencies have advocated for these market reforms because of their expected benefits to competition and consumers.<sup>8</sup> For example, the agencies recognized that with declining economies of scale in wholesale generation technology, nondiscriminatory access and competition in wholesale generation could facilitate greater use of low-cost resources, increased entry, and reduced exercise of market power.<sup>9</sup> In addition, competition to develop electric transmission can produce important benefits because local utility monopolies that might own higher-priced generation may not always have incentives to develop transmission that connects downstream consumers to a competitor's lower-priced generation that might displace the local utility's own generation.<sup>10</sup> Likewise, the agencies have discouraged state laws that might thwart these competitive benefits.<sup>11</sup>

8. These reforms also affect antitrust enforcement. Ordinarily, the merger of two natural monopolies would tend not to raise competitive concerns because the two firms would not compete in the same market. But where there is competition in U.S. electricity markets today, the antitrust laws will work to protect competition in wholesale generation and transmission development from anticompetitive conduct and mergers.

### 3. Publicly Funded “Monopolies”

9. When public funding is a major revenue source for a good or service, a public policy question is how that funding affects provision of the good. Examples may include research and development of pharmaceuticals to treat extremely rare medical conditions (orphan drugs), procurement of defense-related goods and services, or universal service obligations as may exist in industries like healthcare or telecommunications.

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<sup>8</sup> See, e.g., Comment of the Fed. Trade Comm'n at 11, 136 FERC ¶ 61,051 (Sept. 29, 2010) (No. RM10-23-000),

[https://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/ftc-comment-federal-energy-regulatory-commission-concerning-transmission-planning-and-cost.rml0-23-000/100929transmissionplanning.pdf](https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-comment-federal-energy-regulatory-commission-concerning-transmission-planning-and-cost.rml0-23-000/100929transmissionplanning.pdf); Comments of the U.S. Dep't of Just., FERC Docket No. RM99-2-00 (Aug. 23, 1999), <https://www.justice.gov/atr/comments-us-department-justice-0>; Comments of the U.S. Dep't of Justice, FERC Docket Nos. RM95-8-000 & RM94-7-001 (Aug. 7, 1995), <https://www.justice.gov/sites/default/files/atr/legacy/2000/08/03/ferc2.txt>; Reply Comments of the U.S. Dep't of Just., FERC Docket No. RM94-20-0000 (Apr. 3, 1995), <https://www.justice.gov/atr/reply-comments-us-department-justice>.

<sup>9</sup> See, e.g., FTC STAFF REPORT, COMPETITION AND CONSUMER PROTECTION PERSPECTIVES ON ELECTRIC POWER REGULATORY REFORM (Jul. 2000), [https://www.ftc.gov/system/files/documents/reports/competition-consumer-protection-perspectives-electric-power-regulatory-reform/report\\_electric\\_power\\_reform.pdf](https://www.ftc.gov/system/files/documents/reports/competition-consumer-protection-perspectives-electric-power-regulatory-reform/report_electric_power_reform.pdf).

<sup>10</sup> See Order 1000 at P 254.

<sup>11</sup> See, e.g., Statement of Interest on Behalf of the United States, *NextEra v. Walker*, No. 1:19-cv-00626 (W.D. Tex. Sept. 20, 2019) (No. 17-cv-04490), <https://www.justice.gov/atr/case-document/file/1204436/download>; Letter from Daniel Haar, Acting Chief, Competition Pol'y & Advoc. Sec., Antitrust Division to Rep. Travis Clardy, Tex. House of Reps. (Apr. 19, 2019), <https://www.justice.gov/atr/page/file/1155881/download>; Brief for the United States of America as Amicus Curiae in Support of Neither Party, *Vacatur, and Remand, LSP Transmission Holdings, LLC v. Lange*, No. 18-2559 (8th Cir. Oct. 19, 2018), <https://www.justice.gov/atr/case-document/file/1102866/download>.

10. In such circumstances, the government may face several choices. For example, the government could have a make-or-buy decision: to directly provide the service or produce a product where it would “perform[] both internal [e.g., cost-minimization] and external [e.g., price setting] control” or it could rely on “a private regulated firm, [where] ownership belongs to the private sector” and where “the government contents itself with external control and the shareholders exercise internal control.”<sup>12</sup> The economic literature identifies tradeoffs between these two organizational forms, including principal-agent problems, transaction costs associated with contracting, and challenges aligning incentives to rein in costs and improve quality. For example, a recent empirical study looked at make-or-buy decisions across many U.S. cities and found that services whose performance contracts are hard to write and administer tend to be provided internally by cities; this pattern is especially pronounced for large cities.<sup>13</sup>

11. If the government chooses to contract for a good or service, competition principles can help inform some of the decisions facing the government. A well-designed competitive bidding process to be the contractor often can produce meaningful benefits in terms of price and quality. This can include competition for development, during development, for production, and during production. For example, a study of increased competition during development in a military acquisition found development time was reduced by 33 percent, development cost by 42 percent, and average per-unit costs by more than 50 percent, relative to a non-competitive procurement process.<sup>14</sup> As another example, a study of dual-sourcing during production of missiles found cost savings of approximately 20 percent.<sup>15</sup>

12. The government might also weigh the benefits of providing the contract to a single firm or multiple firms and for a short-term contract or a long-term contract. Competition for a long-term contract for a single firm may be leveraged and intensify competition for greater concessions today but at the potential cost of less competition in the future. By contrast, a short-term contract may create more frequent opportunities for competition but potentially may induce higher transaction costs or may reduce incentives for the winning firm to sink investments. Contracting with multiple firms may keep more competitors in the market but also may reduce the government’s ability to take advantage of economies of scale. Many of these tradeoffs are relevant to an analysis of the efficiency arguments private firms make with respect to their own contracting decisions, including the use of exclusives. Of course, with greater use of competition for government outsourcing decisions, competition enforcement becomes vital to ensure that the government and the taxpaying public obtain the benefits of that competition.<sup>16</sup>

<sup>12</sup> JEAN-JACQUES LAFFONT & JEAN TIROLE, A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION 638–39 (1993).

<sup>13</sup> Jonathan Levin & Steven Tadelis, *Contracting for Government Services: Theory and Evidence from U.S. Cities*, 58 J. OF INDUS. ECON. 507, 535 (2010); see generally also JOHN HILKE, COMPETITION IN GOVERNMENT-FINANCED SERVICES (1992).

<sup>14</sup> Dominique Meyers, *Acquisition Reform-Inside the Silver Bullet*, 2002 ACQUISITION REV. Q. 312, 316–17.

<sup>15</sup> Thomas P. Lyon, *Does Dual Sourcing Lower Procurement Costs?*, 54 J. INDUS. ECON. 223 (2006).

<sup>16</sup> See Press Release, Dep’t of Justice, Justice Department Announces Procurement Collusion Strike Force: A Coordinated National Response to Combat Antitrust Crimes and Related Schemes in Government Procurement, Grant and Program Funding (Nov. 5, 2019), <https://www.justice.gov/opa/pr/justice-department-announces-procurement-collusion-strike-force-coordinated-national-response>.

#### 4. Legally-Protected “Monopolies” Involving Intellectual Property

13. For markets involving intellectual property rights, the U.S. DOJ-FTC Antitrust Guidelines for the Licensing of Intellectual Property note that “the Agencies apply the same analysis to conduct involving intellectual property as to conduct involving other forms of property, taking into account the specific characteristics of a particular property right.”<sup>17</sup> Under general principles, when defining a market, competition law should “focus[] solely on demand substitution factors.”<sup>18</sup> Consequently, patents do not necessarily create a monopoly. Alternative substitute technologies (patented or unpatented) may already compete with a patented technology to be used in a specific product, feature, or service. Thus, the original grant of intellectual property rights may be narrower than the whole market initially. Moreover, substitute innovations may develop over time. Lastly, demand for substitutes and customer tastes may evolve over time. As a result, “the Agencies do not presume that intellectual property creates market power in the antitrust context.”<sup>19</sup> The potential lack of market power is important when evaluating whether to challenge an acquisition or conduct involving IP rights. In evaluating any conduct involving IP rights for competition concerns, the U.S. Antitrust Agencies are also mindful that “the aims and objectives of patent and antitrust laws . . . are actually complementary, as both are aimed at encouraging innovation, industry and competition.”<sup>20</sup>

14. Moreover, when evaluating whether an IP owner might use IP rights as part of an unlawful exercise of market power, the Antitrust Agencies apply the rule of reason with “a focus on the actual or likely effects of an arrangement, not on its formal terms,”<sup>21</sup> and urge close consideration of which market raises concerns. In general, IP rights may involve three kinds of markets: goods markets, technology markets, and research and development markets.<sup>22</sup> The U.S. Antitrust Agencies also consider efficiency justifications, including the potential benefits of combining complementary assets, and are mindful that IP licensing “is generally procompetitive.”<sup>23</sup> Because IP licensing arrangements often promote innovation and enhance competition, the U.S. Antitrust Agencies make use of safety zones.<sup>24</sup> As with other forms of private property, certain types of conduct with respect to intellectual property may have anticompetitive effects against which the antitrust laws can and do protect. The exercise of intellectual property rights is neither particularly free from scrutiny under the antitrust laws, nor particularly suspect under them.

<sup>17</sup> DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY 2 (2017), <https://www.justice.gov/atr/IPguidelines/download> [hereinafter IP LICENSING GUIDELINES].

<sup>18</sup> DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 4 (2010).

<sup>19</sup> IP LICENSING GUIDELINES, *supra* note 19, at 2 (2017).

<sup>20</sup> Atari Games Corp. v. Nintendo of Am., Inc., 897 F.2d 1572, 1576 (Fed. Cir. 1990); *see also* Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1362 (Fed. Cir. 1999) (“The patent and antitrust laws are complementary, the patent system serving to encourage invention and the bringing of new products to market by adjusting investment-based risk, and the antitrust laws serving to foster industrial competition.”).

<sup>21</sup> IP LICENSING GUIDELINES, *supra* note 19, at 7 (2017).

<sup>22</sup> *See generally id.* at 8–13.

<sup>23</sup> *Id.* at 2.

<sup>24</sup> *See generally id.* at 24–26.

## 5. Conclusion

Competition enforcers and competition policy must be mindful to hew closely to the specific facts of the market and the conduct of firms, even in markets that fall under the rubric addressed here: “competition for the market.” Competition agencies should account for the potential dynamic, procompetitive incentives firms may face to become established in such markets and also be attentive to ways in which firms’ market positions may not be as durable, may not necessarily afford them market power, or may still promote innovation, quality offerings, and competitive pricing. In that respect, competition agencies should proceed with appropriate rigor and caution when bringing enforcement actions or intervening with new policies.