Department of Justice

THE JUSTICE DEPARTMENT'S ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS -- A COMPETITION POLICY FOR THE 1990s

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American businesses face many challenges going into the 1990s, not the least of which is staying competitive in world markets. A number of steps have been taken during the Reagan-Bush Administration to help American industry meet this challenge, including enactment of the Export Trading Company Act of 1982 and the National Cooperative Research Act of 1984. The Department's new Antitrust Enforcement Guidelines for International Operations, released November 10, are another step. By articulating our enforcement policy as clearly as possible, the Department hopes not only to deter violations of the U.S. antitrust laws, but also -- and this is just as important -- to ensure that uncertainty about our enforcement policy does not deter efficient, procompetitive conduct that will keep U.S. businesses competitive.

I would like to take this opportunity today to discuss the new Guidelines for the first time by addressing three topics. First, I will describe the impetus for the Guidelines and the process we followed in developing them. Second, I will discuss the substantive analysis set forth in the Guidelines with respect to mergers and our rule-of-reason analysis generally. Finally, I will discuss the Guidelines approach to some uniquely "international" issues, including issues of foreign sovereign compulsion and the petitioning of the U.S. or foreign governments for trade actions which may adversely affect U.S. consumers.

The Need for Revised Guidelines

The Guidelines issued this month revise a guide issued by the Department in 1977. The 1977 "Antitrust Guide For International Operations" itself was the result of an effort by the Justice Department to address concern expressed by U.S. businesses in the 1970s. In an era when U.S. industry was just beginning to realize that international operations were the key to competitive survival, the Department was made to understand that uncertainty under the U.S. antitrust laws was deterring beneficial international trade and investment and impeding the competitiveness of American businesses in world markets.

The effort to rewrite the 1977 Guide began three years ago in response to complaints beginning in 1984 by bar groups and others that the Guide no longer accurately stated either the law or the Department's enforcement policy. They were right. The 1977 Guide reflected the more restrictive and ambiguous view of antitrust law and policy prevalent at the time. To the extent the 1977 Guide provided greater certainty at all, it did so in part by prohibiting conduct that was potentially procompetitive. The 1977 Guide ignored some relevant issues. As to others, it provided only a conclusory analysis that failed to take full account of economic realities.

Both the court's interpretation of the antitrust laws and the Department's enforcement policies have changed substantially since 1977. Thus, if American businesses lacked guidance in 1977, by 1988 they were receiving inaccurate guidance.

The revised 1988 Guidelines reflect the fact that the Department currently interprets and enforces the antitrust laws to condemn only those practices that threaten to raise prices or reduce output to U.S. consumers. The Guidelines expressly recognize the increasing relevance of foreign competition to virtually every aspect of antitrust enforcement. And they reflect the more economically sensible approach the courts and the Department apply today to cooperative activity among competitors and to the licensing of technology.

The Department today recognizes, for example, that most joint ventures, whether for R&D, production, or marketing, face stiff competition from foreign firms and often generate efficiencies that outweigh any threat to U.S. consumers. The future competitiveness of many U.S. industries will depend on their ability successfully to develop and deploy new technologies in areas such as superconductivity, high-definition television, robotics, and computer-aided design and manufacturing. The costs of developing these technologies and bringing them to the market as quickly and efficiently as possible may require joint efforts among actually or potentially competing firms, foreign and domestic.

Foreign firms have assured their competitiveness in part by engaging in cooperative ventures. U.S. firms have been somewhat less willing to use this approach. That difference can be attributed in part to a cultural difference -- U.S. businesses (perhaps in part because of our antitrust tradition) tend to compete harder among themselves than do foreign businesses. This competition ethic has undoubtedly contributed significantly to the vigor of our economy and to the superiority of American industries in the past. But new challenges may call for new solutions.

To the extent that procompetitive cooperation is being deterred by unfounded fear of government attack under the antitrust laws, that fear must be eliminated. I hope the new Guidelines send a clear message that legitimate cooperative behavior that makes U.S. industry more competitive will not be condemned by the Justice Department. Unfortunately, the fear of an irrational private suit cannot be disposed of so easily.

Some who commented on our draft Guidelines criticized the draft for failing to spell out the risks of private suits or to make sufficiently clear that conduct which the Department would not challenge might be subject to suit by private parties or state attorneys general. In response to those criticisms, we have tried to make clear in the title and throughout the text of the final version of the Guidelines that the Guidelines provide general guidance with respect to the Department's own enforcement policy only. The Guidelines are not a restatement of the law. As counsel, you should separately evaluate the risk of private litigation by competitors, consumers, and suppliers, as well as the risk of enforcement actions by State prosecutors under the state and federal antitrust laws. In addition, of course, you should be aware of the possible applicability of foreign antitrust laws.

Nevertheless, this explicit and repeated recognition that the Guidelines can be relied upon only as an expression of the Department's enforcement policy does not reflect any lack of confidence in our analysis. I believe the Guidelines represent a correct analysis that is true to the legislative intent that the antitrust laws serve as a "consumer welfare prescription." And the courts would do well to consider and to evaluate the Guidelines' mode of analysis in the years to come.

If there is a theme running through the Guidelines, it is this: The Department is concerned only about conduct that would likely create, enhance, or facilitate the exercise of market power where the risk of such anticompetitive harm is not outweighed by procompetitive efficiencies. "Market power" for this purpose is the power of private firms to restrict output and raise price above competitive levels for a nontransitory period of time.

Although the International Guidelines provide particular guidance concerning international operations, they do much more than that. They provide an extensive statement and illustration of the Department's general enforcement policy with respect to nearly every type of business transaction, from criminal violations of the Sherman Act to monopolization, vertical distribution restraints, joint ventures, intellectual property licensing arrangements, and information exchanges. These Guidelines represent the culmination of and collection of the Reagan-Bush Administration's effort to rationalize and spell out its antitrust analysis of business conduct.

Among their most distinguishing features is the Guidelines' length and breadth; thus, I cannot hope in the short time I have this afternoon to summarize the entire document. Rather, I would like to highlight just three areas of the Guidelines that are of particular importance -- merger analysis, the rule-of-reason paradigm by which the Department analyzes joint ventures, and what I will call, for the sake of convenience, the "international" issues.

Merger Analysis

First, the International Guidelines add to the guidance given in the Department's 1984 Merger Guidelines by illustrating how the Merger Guidelines are applied in specific international contexts. The International Guidelines do not change the Merger Guidelines; rather, they restate the Merger Guidelines analysis in a way that more clearly conveys the intent of the 1984 revisions, especially with respect to the significance of the Herfindahl-Hirschman ("HHI") thresholds and entry analysis. The International Guidelines also elaborate on the Merger Guidelines treatment of foreign competition.

The International Guidelines reiterate that the HHI thresholds are not bright line tests that establish a presumption of challenge. On the one hand, the Guidelines do provide "safe harbors" for mergers that involve unconcentrated markets or that would not significantly increase concentration. In the safe harbor ranges below the HHI thresholds, there is virtually no threat to competition. In those ranges, the numerical simplicity and clarity of HHI safe harbors serves an important function by eliminating the potentially costly risk that such mergers will, somewhere down the line, be challenged by the Department.

When a merger falls outside the HHI safe harbors, the risk of anticompetitive harm warrants greater scrutiny. But a merger that would result in an HHI of over 1800 does not signal automatic or even presumptive challenge. Because the cost of incorrectly blocking a merger can be substantial, we look beyond HHIs before concluding that we should challenge a merger.

First, HHI calculations are only as accurate as the underlying market definition and market share estimations. Moreover, even if the market is correctly delineated, HHIs are only a rough approximation of market power. Consideration of nonquantitative factors -- such as special considerations relating to foreign competition or to changing market conditions -- serves as a check on the accuracy of quantitative predictors of market power.

Second, there is no absolute correlation between concentration and the likelihood of an exercise of market power. Concentration figures are the beginning of the Department's analysis -- the screen that indicates whether it is necessary to analyze further the likely competitive effects of a merger. A merger that exceeds the Merger Guidelines HHI thresholds may result in absolutely no ability to exercise market power for any of a number of reasons. For example, a merger that results in HHIs that exceed the safeharbors represent no competitive threat if any attempt to restrict output and raise price after the merger would be frustrated by new entry or by expansion by fringe firms or if the nature of the product would make successful price and output coordination extremely difficult. In addition, efficiencies that could only be achieved through the merger may be so substantial that, despite its anticompetitive potential, the mergers' likely net effect would not be anticompetitive.

Perhaps the most significant factor that must be considered in addition to concentration data is ease of entry into the market, by both foreign and domestic firms. As the International Guidelines reiterate, however, the Department's analysis of entry conditions is not limited to a Stiglerian analysis of "barriers to entry" -- that is, barriers such as tariffs, licensing and other regulatory restrictions that impose higher costs on new entrants than on existing competitors. 1/ While the existence of such barriers is certainly relevant, the time it will take for entry to occur and the scope of likely entry are more frequently the relevant considerations in the Department's analysis. Essentially, the Guidelines analysis focuses on the extent to which entry in response to a price increase would negate any attempted exercise of market power. If a price increase above prevailing

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1/ G. Stigler, The Organization of Industry 67 (1968).

levels would quickly attract significant new supply of products with sufficient quality, reputation and other relevant characteristics to satisfy consumer demand, it is highly unlikely that an anticompetitive price increase would persist for any significant period of time. Under such circumstances, consumers would not be hurt by a merger regardless of the merger's effects on concentration among existing competitors.

The International Guidelines also clarify our treatment of foreign competition. For some reason, despite the 1984 Merger Guidelines revisions, there still seems to be a misimpression on the part of some in the business community that antitrust analysis ignores foreign competition. The Department's analysis has never, during my tenure, automatically assumed that markets can never be larger than the United States.

The International Guidelines make clear that the Department takes into account all firms, domestic and foreign, that compete to any significant extent. In a particular case, of course, foreign competition may not check the exercise of market power by domestic firms. Factors such as high transportation costs and exchange rates can insulate U.S. firms from foreign competition. So can import quotas, voluntary export restraints, and prohibitive tariffs. In some cases, even the threat of trade barriers can cause foreign firms to compete less vigorously or lead domestic buyers to reject foreign supply as being unreliable. Thus, although the Department does not exclude foreign firms from the market solely because their sales are subject to governmentally-imposed trade restraints, the Department takes those restraints into account in assigning market shares and evaluating the likely competitive effects of a merger.

<u>Rule-of-Reason Analysis</u>

The International Guidelines also provide a single, coherent framework for analyzing the likely competitive effects of conduct under a rule of reason in order to identify when conduct is likely to result in market power. This rule-of-reason paradigm is applied, with some modest variation described in the Guidelines, to all kinds of collaborative efforts or economic integrations among firms that have a potential to generate efficiencies, including traditional joint ventures for production, marketing, or R&D and arrangements for the licensing of intellectual property.

The Guidelines' rule-of-reason analysis uses three steps to identify potential anticompetitive harms. Step 1 focuses on the market or markets in which the integration of the parties' operations occurs -- for example, the "joint venture" market or markets. Step 2 focuses on other markets in which the parties are actual or potential competitors. For example, a joint venture to produce widgets for sale in one market may facilitate the coordination of price or output with respect to some other product or to the sale of widgets in some other geographic market. Step 3 focuses on anticompetitive effects of any vertical restraints associated with the joint venture. Step 3 is necessary because even if the parties to the joint venture are not competitors, under certain market conditions, vertical relationships may create horizontal problems by either facilitating collusion in a relevant market or resulting in the anticompetitive exclusion of competitors.

If the Department's analysis under Steps 1, 2, or 3 uncovers a significant anticompetitive risk, then, under Step 4, the Department considers any efficiencies that the parties show through clear and convincing evidence would result from the transaction and its restraints. The Department will not challenge a transaction if the anticompetitive risk is clearly outweighed by efficiency benefits.

The four steps are designed to ensure that the Department considers every possible anticompetitive effect -- and, where necessary, procompetitive efficiencies -- before reaching a conclusion about the likely competitive effects of a transaction. Many cases of course will not require extensive analysis under each of the four steps. For example, the Department would not apply Steps 1 or 2 if the parties are not actual or significant potential competitors in any market, except perhaps to the extent necessary to determine the competitive relationship of the joint venture members. In addition, it would not matter whether the competitive effects of a transaction were analyzed under Step 1 or Step 2, since the substantive analysis under both steps is essentially identical.

I'd like to make two points about the Department's general rule-of-reason analysis. First, the Department often faces an initial question of characterization -- that is, whether a restraint should be condemned automatically without proof of anticompetitive effects or whether it should be evaluated under a rule of reason and challenged only where it is likely to be on balance anticompetitive. The Department's choice of analysis turns on whether the particular restraint is a type of "naked" restraint of trade that is inherently likely to restrict output and raise price and so rarely generates procompetitive efficiencies, in which case per se condemnation is appropriate. If, on the other hand, a restraint is not "naked," but is plausibly related to some form of economic integration of the parties' operations that goes beyond the mere coordination of price or output and that in general may generate procompetitive efficiencies, then a rule-of-reason analysis is appropriate.

The Department does not attempt to determine at this initial characterization stage whether the economic integration involved in a particular transaction would generate efficiencies. It is enough that the type of integration involved in general generates efficiencies. For example, because standards setting in general often generates efficiencies, the Department evaluates particular instances of standard setting under a rule of reason. The Department considers the specific efficiencies likely to result from a transaction only if the transaction would likely create, enhance, or facilitate the exercise of market power in some relevant market. And a determination that conduct carries a "market-power" risk can only be made on the basis of a market specific analysis such as that embodied in the first three steps of the Department's rule-of-reason analysis.

The Department recognizes that other articulations of the rule of reason place more emphasis at an early stage on proof of efficiencies and their relationship to the restraint. The FTC seems to have adopted such an approach recently. 2/ Although it is not clear that it makes much difference as a practical matter, the Department's rule-of-reason analysis

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2/ See In the Matter of Massachusetts Board of Registration in Optometry, 54 Antitrust & Trade Reg. Rep. (BNA) 1115 (June 13, 1988).

defers consideration of the efficiencies associated with a particular restraint (or group of restraints) until a market-specific analysis indicates that the restraint would likely create, enhance, or facilitate the exercise of market power for two reasons. Most basically, the antitrust laws condemn only conduct that is anticompetitive; competitively neutral conduct does not violate the law. More practically, efficiencies are notoriously difficult to prove, and government lawyers and economists are appropriately skeptical of efficiency claims. Often efficiencies are a matter of faith -- companies invest in some activity and adopt a particular organizational structure in the hope that the bottom line will be improved. Where conduct represents some legitimate form of integration -- in the absence of a reason to believe it will actually likely harm competition -- forcing business people to prove the economic wisdom of their conduct in a Department investigation or in a courtroom, rather than in the marketplace, is prone to error. In short, the alternative to the Department's four-step analysis, which minimizes the initial evaluation of efficiency claims, creates too great a risk that competitively neutral conduct will be condemned.

Second, as a general matter, the Department considers restraints associated with a transaction cumulatively, rather than separately. That is, the Department does not attempt to isolate the precise anticompetitive effects or efficiencies associated with particular restraints. Indeed, the anticompetitive risks or efficiencies may result from the interaction of several or all of the restraints associated with a transaction. The Department takes the package of restraints in a joint venture, intellectual property license, or distribution arrangement as the parties have negotiated them. If, considered cumulatively, the restraints associated with a transaction would likely have an anticompetitive effect that is not offset by procompetitive efficiencies, then the parties are free to restructure their transaction to eliminate the risk of anticompetitive effects. Moreover, if a particular anticompetitive restraint contributes nothing to achieving the efficiencies, the Department may seek to strike the restriction. Except in those rare circumstances, however, it is up to the parties to decide what is "necessary" to achieve their objective, and they have the right to do so under our analysis unless that choice is on balance a threat to consumer welfare.

"International" Issues

The 1988 Guidelines also update the Department's approach to what I will call the special "international issues." It was this area of the draft Guidelines published in June that attracted perhaps the most attention and controversy. We paid close attention to those comments, and that is reflected in the final Guidelines.

As a general matter, in order adequately to preserve and promote competition in the United States, the Department at times may take enforcement action against foreign actors or foreign conduct that has a direct, substantial, and reasonably foreseeable anticompetitive effect on U.S. commerce. This approach is consistent with sound economics, our own law, and the approach taken by many of our trading partners.

Indeed, in its decison in the Woodpulp case 3/ issued by the European Court of Justice in September, the Court upheld the European Commission's exercise of jurisdiction under Article 85 of the Treaty of Rome over alleged offshore agreements to fix the price of goods sold in the common market. The decision never used the dreaded phrase "effects test," and it pointed out that the parties sold wood pulp in the Community. Nevertheless, as a practical matter, the decision is very close to, if not indistinguishable from, the so-called "effects" test as applied by U.S. courts and set forth in the Foreign Trade Antitrust Improvements Act. Accordingly, the Department's stated view that a direct, substantial, and reasonably foreseeable effect on U.S. commerce is sufficient basis for the exercise of jurisdiction by U.S.

3/ A. Ahlstrom Osakeytio v. EC Commission, Case No. 98/85 (Ct. of Just. of the Eur. Communities Sept. 27, 1988).

courts represents the mainstream approach to the jurisdiction of a nation's competition law. In light of the Wood Pulp decision, I believe it would be extremely difficult in most cases, especially for members of the European Community, to argue that applying our antitrust laws to foreign conduct that substantially affects our marketplace is an improper exercise of "extraterritorial" jurisdiction.

Nevertheless, our antitrust laws do not operate in a vacuum. Sometimes our enforcement interests will give way to other interests that may arise -- such as when conduct is compelled by a foreign sovereign; when it constitutes the petitioning of governmental agencies or legitimate action under the U.S. trade laws; when the conduct in question has a greater affect on significant foreign national interests than on U.S. interests and deference to those foreign national interests is appropriate; and, in rare cases, when the Executive Branch determines that an enforcement action would have such a deleterious effect on U.S. foreign relations as to counsel forbearance. As much as we antitrust lawyers may view the principles and objectives of the antitrust laws as preeminent, the fact is that society has not always agreed. Many of the trade laws and much of the government's trade negotiations and their inevitably anticompetitive effects are important examples. As antitrust apostles, we may not be happy with those choices, but we must respect them. The threat of antitrust enforcement should not be used to thwart the lawful achievement of the objectives of other laws, no matter how unwise they may seem.

Similarly, the United States is not alone in the world; it meets its trading partners as a sovereign equal. Moreover, for better or worse, the economic policies of governments are becoming increasingly intertwined. A blunderbuss approach to antitrust enforcement that does not seek to accommodate the much larger universe of contacts and relationships among nations will generate frictions that ultimately have the effect of reducing free world trade.

This does not mean, however, that federal judges should assume a role as mini-diplomats every time they consider an antitrust case with an international flavor. The judicial branch is independent of foreign policy coordination; giving the judiciary unlimited discretion under the guise of "international law" or other equally amorphous notions to consider and resolve trade frictions created by antitrust suits would do more harm than good. Rather, application of objective, discrete doctrines such as the Noerr-Pennington doctrine and the doctrine of foreign sovereign compulsion, combined with a faithful adherence to the "direct, substantial and reasonably foreseeable" effects test, should eliminate most concern. Perhaps further legislation, which was endorsed by the Administration several years back and which provides an objective and limited jurisdictional rule of reason, may also be advisable. Courts, however, should never be allowed to dismiss a case on the ground of "foreign relations."

The Department is not similarly constrained. We are part of the Executive Branch, and coordination with foreign and trade policy is not only possible, it has been accomplished. Thus, a more flexible approach to avoiding antitrust actions that generate disproportionate trade frictions is possible. The Guidelines describe that approach in some detail.

Petitioning of U.S. and Foreign Governments

For example, the International Guidelines indicate that the Department will not prosecute businesses for legitimate petitioning of either foreign or U.S. governmental entities so long as the petitioning activity does not fall within the "sham" exception to the Noerr-Pennington doctrine. The Noerr-Pennington doctrine rests on a construction of the Sherman Act that is derived both from the First Amendment right to petition government and from the need of government to receive communications with respect to actions within their sovereign sphere of authority. Moreover, it would be unfair and unwise to disadvantage U.S. businesses operating abroad by essentially forbidding them from petitioning foreign governments.

With respect to petitioning activity under laws -- such as section 337 of the 1930 Tariff Act -- which have the express purpose of allowing firms to exclude competitors under certain circumstances, the Department will rely on objective, rather than subjective, evidence of "sham" petitioning. The Department will not consider the filing of such an action to be sham as long as the petitioner had some reasonable basis for making its claim unless the Department had specific evidence that the petitioner believed its claim to be meritless.

Foreign Sovereign Compulsion

The Department also recognizes that in some cases foreign sovereign authorities may compel private parties to engage in conduct that has an anticompetitive effect in the United States. Both deference to foreign sovereigns acting within their legitimate spheres of authority and fairness to firms subject to such compulsion counsel against prosecuting such private conduct. Indeed, it can be argued that the Sherman Act does not apply to private conduct that is not voluntary, but is the result of governmental compulsion. In any event, it certainly would be anomalous to prosecute such conduct criminally. The Department therefore will not prosecute anticompetitive conduct that has been compelled by a foreign government where refusal to comply would result in the imposition of significant penalties or to the denial of substantial benefits, other than benefits that flow directly from engaging in the anticompetitive conduct, unless the compelled conduct plainly has accurred wholly or primarily in the United States.

This is one area in which the Department made a significant change to the draft Guidelines in response to comments by the ABA and others. Specifically, the final Guidelines recognize that in addition to the imposition of substantial penalties, the denial of substantial benefits that would substantially impair the ability of a firm to compete can also constitute compulsion. In addition, the final Guidelines eliminate the caveat that the "defense" of foreign sovereign compulsion would not be recognized where deference to the foreign sovereign's actions would not be warranted under the circumstances. The Department initially proposed taking this position because we viewed the doctrine of foreign sovereign compulsion as being based on deference to the legitimate actions of a foreign sovereign. As the ABA task force pointed out in its comments, however, the doctrine of foreign sovereign compulsion is widely regarded as being based as well on principles of fairness to firms subjected to the compulsion and to a construction of the Sherman Act under which nonvolitional behavior cannot form the basis for at least a criminal violation. Because I was persuaded by these arguments, we omitted the caveat to the foreign sovereign compulsion defense contained in the original draft.

As we stated in our brief in Matsushita, 4/ however, the Department believes that the defense of foreign sovereign compulsion must be distinguished from the federalism-based state action doctrine. The state action-- or Parker-- doctrine in effect immunizes private anticompetitive conduct that is engaged in pursuant to clearly articulated state policies and is subject to active state supervision.

For one thing, the premise of the state action doctrine does not apply in the international context. The state action doctrine embodies the notion that the states should be allowed to employ a wide range of regulatory alternatives consistent with the Sherman Act. The Supremacy Clause stands as the guardian against state programs that have a noxious effect on interstate commerce. The same scheme and relationship does not exist in the international context.

Morever, a standard like that of the state action doctrine would be difficult to apply to the actions of a foreign government. Given the inherent novelty of many foreign legal systems and the difficulty of obtaining foreign-located evidence, defendants would have many opportunities to attempt

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4/ Brief for the United States as Amicus Curiae supporting petitioners, Matsushita Elec. Ind. C., Ltd. v. Zenith Radio Corp., No. 83-2004 (June 1985).

to evade legitimate application of the U.S. antitrust laws whenever there was even an arguable foreign national policy underlying anticompetitive conduct. In addition, the use of an active state supervision standard like that used in state action cases would require difficult and sensitive inquiries into the foreign sovereign's conduct of its own affairs. Therefore, although for reasons of comity the Department may refrain from bringing an enforcement action even where compulsion does not exist, it would be unwise to transport the Parker doctrine and all that it entails to the international context.

Conclusion

By making the Department's enforcement policy more predictable and more understandable, the Department's International Guidelines should eliminate the unwarranted spectre of government challenge to procompetitive conduct. Thus, irrational fear of government enforcement actions, at least, should not impede U.S. competitiveness in world markets in the 1990s.