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Remedies in Exclusive Dealing Cases

Andrew J. Heimert

United States Federal Trade Commission

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Overview

- Remedies in Unilateral Conduct Cases
  - The Importance of Remedies
  - Possible Remedial Goals
  - Possible Remedial Tools
  - Costs and Benefits of Various Remedies
- Remedies for Abusive Exclusive Dealing
  - Considerations of Efficiency
  - “Fencing in” Relief in Exclusive Dealing Cases
  - U.S. case examples

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The Importance of Remedies

- Designing remedies in unilateral conduct cases presents particular challenges that one is less likely to confront than in mergers or cartel/agreement cases.
- Unlike mergers, which can be blocked, or price-fixing and other collusion cases, where actions can be simply enjoined, single-firm monopoly cases involve a change in market structure that may require more than an injunction to fix.
- An effective remedy is as important as an effective investigation or prosecution.
- Remedies should be considered at the beginning of an investigation.

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Possible Goals of Remedies

- Stopping unlawful conduct and preventing its recurrence
- Restoring competition in the relevant market
- Deterrence
- Compensating victims

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Possible Remedial Tools

- Types of remedies in unilateral conduct cases:
  - Prohibitory conduct remedies (cease and desist)
  - Affirmative conduct remedies
  - Structural remedies
  - Penalties
- Different remedies have different administrative costs (remedy design and ongoing administration), and different effects on efficiency and innovation.
- The preferred remedy will be the one that accomplishes the remedial goals of the relevant jurisdiction while minimizing the costs of remedy design and administration and the risks of chilling efficient conduct and incentives to innovate.

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Prohibitory Conduct Remedies

- Enjoin the conduct found to be illegal.
  - May also include "fencing in" relief that prohibits conduct having similar effect realized through similar means.
- Low up-front administrative costs, and low risk of chilling efficient conduct. However, incentives to engage in abusive conduct will likely continue (unless dominance is fragile), so ongoing monitoring costs can be high.
  - Defining the "fence" can increase up-front administrative and monitoring costs, and may chill more efficient conduct.
- A standard remedy in unilateral conduct cases, but not always sufficient to restore competition.
- Do not deter future wrongdoing or compensate victims.

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Affirmative Conduct Remedies

- Obligates the defendant to take certain affirmative actions to restore competition.
- May be appropriate where prohibitory remedies are inadequate to restore competition.
- Relatively costly to design and administer, and can risk chilling efficient conduct and incentives to innovate.
  - Enforcer must identify the steps necessary to restore competition.
  - High oversight costs, especially with access remedies.
  - Forced sharing may diminish the incentives of the defendant, its rivals and similarly situated firms in other industries to invest in innovation.
- Avoiding affirmative remedies of long duration, especially in dynamic industries, may mitigate potential costs.
- Usually don't deter wrongdoing or compensate victims

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Structural Remedies

- Requires the sale/divestiture of part of the defendant's firm (business unit, assets, etc.).
  - While frequently used in merger/acquisition matters, they are extremely rare in unilateral conduct cases.
- Advantages:
  - Can rapidly eliminate market power and restore competition.
  - "Fix it and forget it": Changes the defendant's incentives, reducing monitoring costs. Remedy is generally self-enforcing.
- Disadvantages:
  - Can have significant up-front remedy design costs, depending on the assets to be divested and the organization of the firm.
  - Can involve monitoring costs, especially if remedy includes ongoing interactions.
  - Can destroy efficiencies.
  - May be disproportionate to severity of harm from conduct.
- Types of structural relief:
  - Horizontal or vertical divestiture.
  - Divestiture of property rights.

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Monetary Penalties

- Advantages
  - Easy to administer, hard to evade.
  - Deters unlawful conduct, can compensate victims.
- Disadvantages
  - Can be difficult to set the optimal fine.
  - Need to balance under and over-deterrence.
  - Monetary penalties don’t usually restore competition.

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A Remedial Taxonomy

	Prohibitory Conduct	Affirmative Conduct	Structural	Monetary Penalty
Stop/Prevent Illegal Conduct	+		+	
Restore Lost Competition		+	++	
Deterrence				+
Compensation				++
Remedy Design Costs	+	–	– –	
Remedy Administration Costs		–	+	++
Effect on Innovation and Efficiency	+	–	–	

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General Suggestions for Defining Remedies

- William Kovacic (1989):
  - Promptly define the remedial objectives and develop a plan to achieve them
  - Understand the industry
  - Make adjustments if there is a history of misconduct
  - Anticipate the defendant's likely response
  - Identify side effects
  - Analyze administrability
  - Select a remedy
  - Develop a framework for implementation

Suggestions for Drafting Remedies

- Remedies must be clear enough so that the defendant/dominant firm, the administering agency, and the defendant's competitors all know whether particular conduct complies with the remedy.
- Provisions merely reciting general statutory language are pointless, and vague provisions are unlikely to induce effective compliance without extensive further proceedings.
  - May also be unenforceable in court.
- A remedial decree may have to identify specific conduct in which the dominant firm is permitted to engage.
- The order should be of sufficient duration to encourage entry and expansion of competitors.
  - However, a remedy of overly long duration can stifle a firm's flexibility and may impose unnecessary costs.

Ensuring Compliance with the Remedy

- Regular compliance reports to the agency.
- Document retention obligations.
- Access to the defendant's employees and records.
- Appointment of a special monitor.
- Antitrust compliance program within company.
- Fines for failure to comply.

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Remedies for Exclusive Dealing

- Prohibitory conduct remedies an obvious choice, but challenges remain.
- Exclusive dealing—even by a dominant firm—can be efficient. Prohibition should be limited to the market in which competition was harmed, and be no broader than necessary to realize the remedial goals.
- An example: U.S. DOJ Microsoft case prohibited exclusive dealing arrangements "that have a significant degree of foreclosure on the market" for a period of 5 years.
- Another example: U.S. FTC Intel case allowed exclusive dealing where (i) necessary to recoup investment in specialized products for specific customers; (ii) no longer than 30 months in duration; and (iii) limited to the specific products that were customized for that specific customer.
- Contracts entered into by the defendant on an exclusive basis may need to be renegotiated, especially if exclusivity offered for a discount.

"Fencing In" Relief in Exclusive Dealing Cases

- Many types of conduct may replicate effects of exclusive dealing, and exclusive dealing remedies in the United States often prohibit some or all forms of the following:
  - Retaliation and termination against disloyal customers
  - Market-share rebates
  - Bundled pricing
- As with exclusive dealing generally, these forms of exclusivity can be efficient, and care must be taken to avoid discouraging efficient conduct.

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Case Example: FTC v. PoolCorp

- FTC investigation resolved in 2011.
- World's largest distributor of swimming pool products, and operates approximately half of all pool equipment distribution facilities in the United States.
- Only nationwide distributor in United States.
- Through a series of acquisitions, it had grown to operate over 200 distribution centers throughout the United States.
  - By way of comparison, the next largest U.S. distributor operates less than 40 centers.

http://www.ftc.gov/os/caselist/1010115/index.shtm

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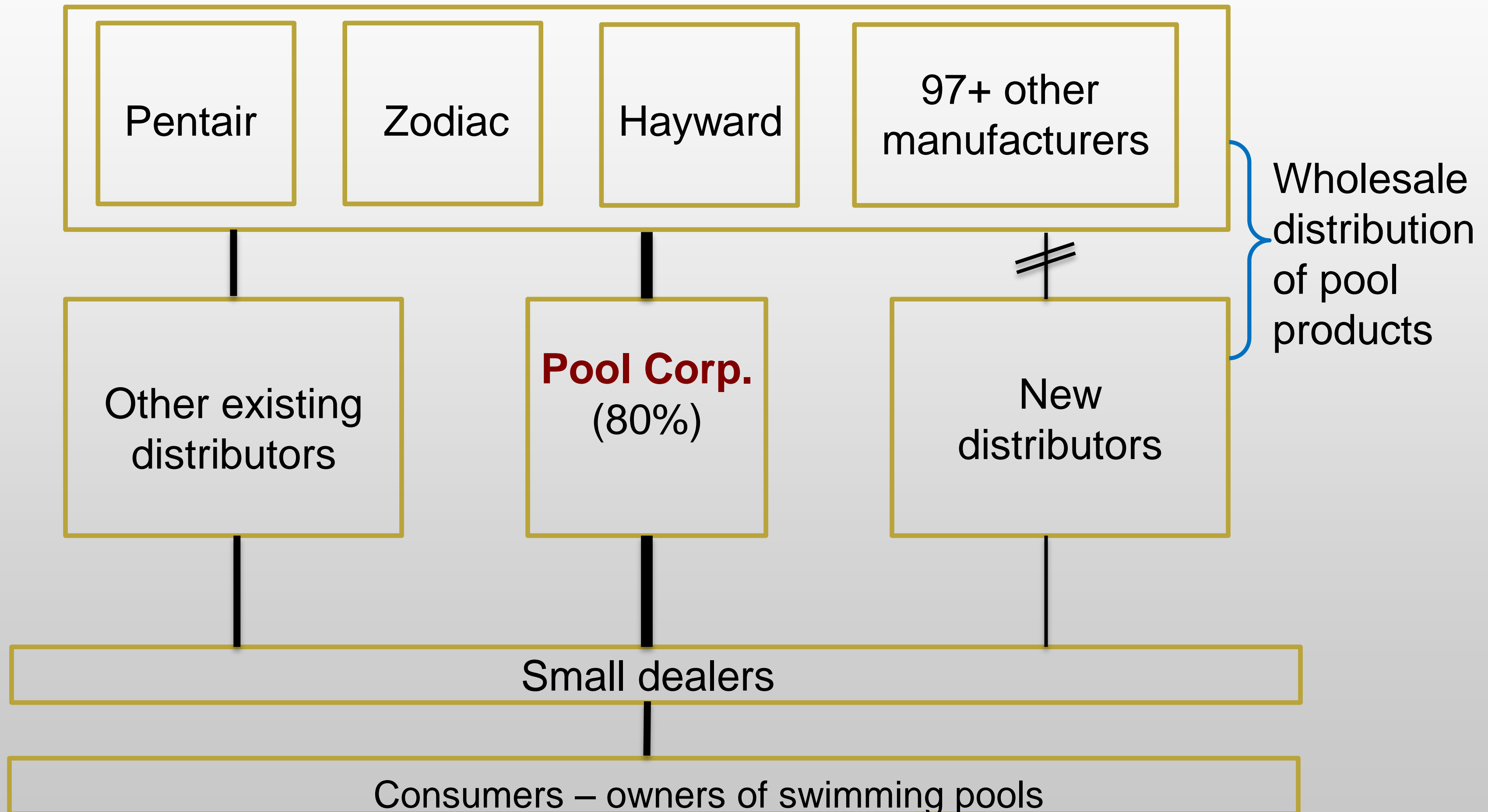
FTC v. PoolCorp



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FTC v. PoolCorp

- When a new distributor attempted to enter a local geographic market, Poolcorp threatened to terminate the purchase and sale of the manufacturer's pool products nationwide if they also supplied the new entrant. PoolCorp did not apply its policy to existing rivals.
- After receiving these threats, manufacturers, including the three "must-have" manufacturers, refused to sell pool products to the new distributors and canceled any pre-existing orders.
- PoolCorp's threats effectively foreclosed new distributors from obtaining pool products from manufacturers that represented more than 70% of all pool product sales.
- No viable alternatives for additional competing distribution methods.
- PoolCorp's strategy significantly increased a new entrant's costs of obtaining pool products and prevented them from creating competitive constraint.
- No pro-competitive justifications (efficiencies) for PoolCorp's conduct.

FTC v. PoolCorp

PoolCorp prohibited from:

- Pressuring, urging or otherwise coercing manufacturers to refrain from selling, or to limit their sales, to any distributors other than PoolCorp;
- Discriminating or retaliating against a manufacturer for selling, or intending to sell, pool products to any distributor other than PoolCorp; and
- Conditioning the sale or purchase of pool products, or membership in PoolCorp's preferred vendor programs, on the intended or actual sale of pool products by a manufacturer to any distributor other than PoolCorp.

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FTC v. Transitions Optical

- FTC investigation resolved in 2010.
- Transitions Optical produced photochromic lenses as part of the eyeglass manufacturing process (these lenses darken when exposed to sunlight).
- Produced over 80% of photochromic lenses for past 5 years.
- Industry has high barriers to entry: capital costs, intellectual property, and regulatory requirements.

http://www.ftc.gov/os/caselist/0910062/index.shtm

FTC v. Transitions Optical

Untreated Lenses

Treated Lenses

Transitions	← Untreated Lenses / Treated Lenses →	Lens Casters

Lens Casters → Independent Wholesale Labs; Lens Caster-Owned Wholesale Labs; Integrated Optical Retailers

Independent Wholesale Labs → Independent Eye Care Practitioners

Lens Caster-Owned Wholesale Labs → Independent Eye Care Practitioners

Independent Eye Care Practitioners → Consumers of Photochromic Lenses

Integrated Optical Retailers → Consumers of Photochromic Lenses

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FTC v. Transitions Optical

- Began with exclusive dealing with lens casters.
  - Transitions terminated lens casters who dealt with potential competing products, Corning (SunSensors) and Vision-Ease (LifeRx).
- Transitions also entered into exclusive agreements with retailers and "preferred" promotion agreements with labs.
  - Gave up-front payments/rebates to retailer for long-term exclusive agreements.
  - Gave labs rebates if they withheld sales efforts for competing products.
  - Gave discount to retailers and wholesale labs if customer bought all of its photochromic needs from Transitions.
- Requiring exclusivity of lens casters foreclosed 85% of sales opportunities at this level of distribution.
  - Amplified by exclusionary practices with retailers and wholesale labs, foreclosing 40% of this distribution channel.
- No procompetitive efficiencies justified conduct.

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FTC v. Transitions Optical

Transitions prohibited from:

- Entering exclusivity agreements with lens casters, including any agreements providing favoritism to Transitions (or disfavoring competing photochromic treatments);
- Allows exclusive agreements with retailers and wholesale labs, but they must be terminable with 30 days' notice, and only partially exclusive if requested by customers;
- Prohibits various "de facto" exclusive dealing accomplished through market share discounts and other means; and
- Certain other restrictions.