

## Part 2 Comprehensive Review of Monopoly and Oligopoly Regulations

### Introduction

It has already been twenty-five years since Japan incorporated two provisions into the Antimonopoly Act in 1977 to deal with problem conduct at firms in industries with monopolistic and oligopolistic market structures. The provision for measures against monopolistic situations (Section 8-4) and the provision for reporting parallel price increases (Section 18-2) were enacted against the backdrop of so-called managed price problems, in which formation of prices that are inflexible in a downward direction takes place as market structures become more oligopolistic. During this quarter-century interval, the economic conditions surrounding monopolies and oligopolies have changed completely. There is the gradual advance of deregulation centered on sectors that had come to be considered so-called natural monopolies, which could not have been imagined in 1977, to cite just one instance. Even in public utility sectors involving electricity, gas, electricity transmission and airlines, for example, the entry of new competitors has proceeded aggressively as a result of deregulation.

At the same time, however, one problem has been pointed out in the public utility sectors where this new competition has been introduced: competitive principles are not functioning effectively because existing entrepreneurs possess the essential facilities needed to compete. Monopoly problems are also emerging along with the formation of technology standards, through network externalities based on development of the latest technology innovations. The question of how to respond to these problems through competition policy has therefore become a major issue.

Against the backdrop of these changes in economic conditions, the Study Group conducted a study concerning the question of whether the provisions of Section 8-4 and Section 18-2 introduced in 1977 can respond adequately to the monopoly and oligopoly problems of the modern era, and how these provisions should be revised if they cannot.

## Chapter 1      What Problems are We Seeking to Address Under The Antimonopoly Act as Problems that Originate in the Organization of Today's Monopoly and Oligopoly Markets?

### 1 Basic Thinking

The problem of monopolies or problem of technology standards that occur in the process of introducing competition into public utility sectors such as electricity, gas, electricity transmission and airlines can be cited as problems arising from today's monopolistic and oligopolistic market structures.

Of these, the public utility sectors were sectors where subscriber line networks, transmission grids and other facilities were constructed under regulations that were created on the premise of a "natural monopoly"<sup>1</sup> that went hand-in-hand with policy decisions such as avoidance of redundant investment caused by the need for substantial capital investments and the decreasing nature of supply side expenses. These are now sectors where the government is introducing competition through deregulation, however, in order to promote competition in markets that supply goods and services using the facilities in question (referred to below as "use markets"). Furthermore, unlike the public utility sectors, technological standards are formed based on market competition, not on systems, and cases can be seen where use markets become monopoly markets because demand network externalities<sup>2</sup> are extremely strong. The common characteristic of both instances is that compared to normal markets, competition is difficult to develop. The reason cited for this characteristic is the extreme difficulty in constructing the facilities or technology that enable the competitors themselves to compete effectively, because of natural monopoly characteristics or network externalities, and when entrepreneurs do not use the facilities or technology of the existing firms they cannot be active players in the market. As

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<sup>1</sup> Refers to a condition in which a monopolistic situation will emerge naturally through economies of scale (where the average cost for one unit of a good or service declines as the scale of supply expands) or economies of scope (where a firm's total costs assumed to be necessary when that firm manufactures multiple types of goods or services is small compared to the total of costs when manufacturing each good or service on a standalone basis) when the markets are left to themselves; frequently seen in markets that have been established as monopolies by government regulation, often in situations where the decreasing nature of large scale expenses on the supply side or the need for substantial capital investment is recognized.

<sup>2</sup> The phenomenon in which the value of a network increases as the number of individuals participating in the network increases; also known as network effect. The utility increases for the user's side as greater numbers of people participate in the network, which in turn has the effect of further encouraging even more people to join the network. *Survey Concerning the Proper Approach to Regulation in a Networked Society*, a survey report prepared by Fiscal 2001 Cabinet Order (Mitsubishi Research Institute, May

a result, the owners of such facilities or technology can maintain or enhance their own position by engaging in unprofitable transactions in competition against competitors because they command the key elements for business operations by competitors. Accordingly, the question of how to ensure fair competition in such sectors when entrepreneurs that own the facilities or technology can make competitors use said facilities or technology may be said to have become a pressing issue.

## **2 Monopoly Based on Exclusive Possession of Facilities or Other Indispensable Assets Accompanying the Introduction of Competition Based on Deregulation**

### **(1) Monopoly Based on Independent Ownership, Exclusively or in Common, of Essential Facilities in the Process of Competitive Entry Accompanying Deregulation**

In public utility sectors such as electricity, gas and electricity transmission, where monopolies were authorized in the past under business law, the introduction of competition based on deregulation is proceeding in the form of competitors using facilities constructed by existing businesses to provide services. There are concerns, however, that the principle of competition will not function effectively in these sectors when the facilities in question are so-called “essential facilities” (facilities acknowledged as necessary and indispensable when conducting business, but recognized as being difficult practically to construct new through investments, etc. in facilities that would a firm to compete effectively. See Part 4 “Definition of Essential Facilities.” The same applies in Section 1 below).

In these types of markets, the concern is that the effects from introducing competition merely by authorizing market entry will be limited. This is why it is recognized in the Antimonopoly Act as well that if conduct is found that hinders the encouragement of market entry in the relevant markets, the law should deal with such conduct swiftly and effectively.

### **(2) Specific Competition Policy Problems Originating in the Monopolistic Market Structure Described Above**

We believe that in the public utility sector, in situations where entrepreneurs that independently own, exclusively or in common, essential facilities and conduct their own business

activities in the use market while simultaneously causing other entrepreneurs to also use the facilities in question<sup>3</sup>, competition-related problems such as those described below may occur because the businesses that independently own, exclusively or in common, the essential facilities are able to develop their business in the use market in question from an advantageous position, given that the division owning the essential facilities and the sales and marketing division in the use market in question are the same and are not organizationally separate.

**A. Conduct concerning the use of essential facilities**

**(a) Permission or denial to use essential facilities, discrimination, and transaction-based restrictions and obligations**

When businesses that independently own, exclusively or in common, essential facilities and cause others to use such essential facilities, by means such as engaging in conduct on one's own or through or related businesses, and cause disadvantageous transactions against competitors as described below, this places the competitors in a disadvantageous position for competition and distorts competition in the use market for the essential facilities, and such conduct must be dealt with swiftly and effectively under the Antimonopoly Act.

(Examples)

- A provider denying connection to a subscriber line network, or setting connection conditions that are more disadvantageous than those for businesses related to the provider, when competitors manage an ADSL service.
- An exclusive owner establishing conditions on competitors that create a disadvantage when competing, such as delaying the start of service or requiring exorbitant connection fees for use of supply lines, when competitors provide gas supply to customers who are free to select a supplier.<sup>4</sup>

**(b) Conduct to use a position of independent ownership, exclusively or in common, essential**

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<sup>3</sup> We regard this as a similar problem not only in situations where businesses are competing strictly with competitors, but also in situations where they themselves or businesses related to them are competing with competitors in use markets for the essential facilities in question. Furthermore, normally, any conduct that obstructs fair competition among users by treating specific users unfairly through discrimination when a company itself has not advanced into the use market is equivalent to an unfair trade practice (such as discriminatory pricing, discriminatory treatment, etc.).

<sup>4</sup> Large volume gas consumers that set the gas charge and other fees by individually negotiating the gas supply with a gas company; refers to gas consumers with an annual contract volume of one million cubic meters or more under the Gas Utility Industry Law currently in force.

### facilities to prevent or obstruct the movement of customers to competitors

In some cases, a business that independently owns, exclusively or in common, essential facilities can place competitors in the use market for the essential facilities in a competitively disadvantageous position, even when its conduct does not amount to discrimination involving the use of the essential facilities between itself or parties related to it and the competitors. Specifically, situations can be envisioned where a business that independently own, exclusively or in common, essential facilities will prevent or obstruct the movement of customers, by having the division that owns the essential facilities provide internal assistance to the sales and marketing division in the use market, through conduct such as using its unique position originating in the fact the division owning the essential facilities and the sales and marketing division in the use market are identical to prevent or obstruct customers from moving to another provider, or enacting policies to keep its own customers from moving to competitors based on information related to approval for use of the facilities in question, or continually increasing usage fees to competitors for the facilities while selling product inexpensively to its own customers.<sup>5</sup>

For example, conduct in the use market for essential facilities such as that described below will place competitors in a competitively disadvantageous position and distort competition in the use market for the essential facilities, and such conduct must be dealt with swiftly and effectively under the Antimonopoly Act.

#### (Examples)

- A provider supplying electricity using its own exclusively owned electricity transmission network to customers that are free to select a supplier<sup>6</sup> presses those customers not to sign a contract with a new market entrant based on information concerning the new market entrant and its customers obtained from owning the electricity transmission grid.
- (c) Conduct in parallel to prevent entry by two or more entrepreneurs that have been exclusively allocated usage rights for essential facilities by the central government or other public institution

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<sup>5</sup> This last practice is also referred to as "price squeezing."

<sup>6</sup> Large volume electricity customers that set the electricity charge and other fees by individually negotiating the electricity supply with an electric utility; refers to electricity consumers with 2,000kW or more as maximum power use (special scale demand) delivered at extra high tension (20,000V or higher voltage) under the Electricity Utility Industry Law currently in force.

For example, in cases where entrepreneurs engage in conduct that distorts competition without collusion<sup>7</sup>, such as in the airline business sector when two or more entrepreneurs have been exclusively allocated usage rights to essential facilities by the central government or other public institutions, engage in conduct against an entrepreneur such as a new market entrant, which has only a few airport take off and landing slots and has been placed in a markedly disadvantageous position for using essential facilities, such to make the business activity of the entrepreneur in question difficult and prevent market entry by setting low prices only on the routes of the entrepreneur in question, will not present a danger of making the business activity of a competitor difficult when practiced by only one company independently, but may present a danger if such conduct is practiced in parallel by two or more entrepreneurs.

As this suggests, in markets where the barriers to entry have become extremely high because the usage rights to essential facilities have been exclusively allocated to a limited number of entrepreneurs by the central government or other public institutions, conduct that serves to distort competition by undercutting the business foundations of competitors – even though active competition among the entrepreneurs that have been exclusively allocated those usage rights is functioning as expected – the effect on competition is substantial, and such conduct such as the examples described below must be dealt with swiftly and effectively under the Antimonopoly Act.

(Examples)

- When concerns arise that conduct by two or more existing entrepreneurs that have been allocated a proportionate share of take-off and landing slots for a certain airline route to lower prices, in parallel and without collusion, only for flights close in time on routes where certain competitors have begun flights, will render the business activity of the competitors or other parties difficult.
- When concerns arise that conduct by two or more existing entrepreneurs that have been allocated a proportionate share of the radio spectrum for a certain cellular telephone to delay connections, for example, in parallel and without collusion, only against certain competitors, will render the business activity of the competitors difficult.

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<sup>7</sup> In the event there is collusion, such conduct will be equivalent to a private monopolization or unfair trade practices (Concerted refusal to deal (boycotts))

### 3 Monopoly Problems Accompanying Standardization Based on Technological Innovations

#### (1) Formation of De Facto Standards Based on Technological Innovations

When demand network externalities exist in sectors such as software and semiconductors, de facto standards (referred to below as “technological standards”) are formed that become the essential facilities whose influence is considered to extend even into use markets for products such as complementary goods (technology such as the basic operating system (OS) for personal computers, 3.5-inch floppy disks<sup>8</sup>, etc.).

Because product convenience expands if technological standards are established, and firms use these standards as a premise to engage in competition that also improves consumer convenience, from the standpoint of competition policy it is not considered necessary to focus on the formation of technological standards themselves as a problem.

However, we believe there are important situations where the JFTC should swiftly and effectively regulate conduct that serves to exclude alternative technologies, or conduct to prevent entry into use markets for technological standards, based on the Antimonopoly Act, and to the extent necessary implement the competition restoration measures necessary to create alternative technologies or ensure the fair use of technological standards, to stimulate competition and utilize competition to increase economic welfare (however, the situations subject to regulation must be limited to those where causing competitors to use the technological standards in question through appropriate terms and conditions is recognized as necessary, as described below in Part 3 Essential Facilities – Definitions).

On the other hand, with regard to policies to execute corporate divisions, or policies to intervene directly against monopoly abuses such as high prices and high profit margins in order to correct monopoly abuses, we believe the former requires prudent procedures and is incompatible with the intent of this comprehensive review to consider prompt and effective measures against conduct to restraint market entry, and we believe it is necessary to consider the danger of the latter creating economic inefficiency at firms.

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<sup>8</sup> Sony set this standard in 1980. In 1983, Sony announced it had signed an agreement to make Hewlett-Packard the OEM (original equipment manufacturer; a company that manufactures a product to be sold under another company's brand name) for 3.5-inch floppy disks. Because this standard was later adopted by NEC (1983) and Apple Computer (1984), 3.5-inch floppy disks achieved a dominant market position and become the global technological standard.

## (2) Specific Competition Policy Problems Originating in the Monopolistic Market Structure Described Above

The monopoly problems of technological standards must be considered by separating them into ① problems of exclusion of alternative technologies to the technological standards that competitors decide to create themselves and ② problems of conduct detrimental to competitors in the use market, as discussed below.

### A. Exclusion of alternative technology to technological standards that correspond to essential facilities

The JFTC must fairly and strictly take steps under the Antimonopoly Act to correct the situation when alternative technology to a technological standard that corresponds to essential facilities is created and a firm or firms engage conduct that serves to exclude this alternative technology<sup>9</sup>. Such conduct certainly includes exclusionary conduct by entrepreneurs that have a monopolistic position against new entry, and we believe it is possible in many instances to address such conduct with the provisions prohibiting private monopolizations currently in force. From the standpoint of invigorating competition, however, we believe it is necessary to respond rigorously against conduct to prevent market entry into use markets by entrepreneurs that independently, exclusively or in common, own technological standards as described below, which serves to prevent the formation of alternative technologies, for example by not adequately disclosing to competing entrepreneurs the interface information for a technological standard that corresponds to essential facilities.

### B. Conduct concerning the use of technological standards that correspond to essential facilities

In situations where technological standards can be called indispensable for business activities by competitors when such competitors want to use the technological standards to offer a service, problems similar to the problems described so far at public utilities will occur.

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<sup>9</sup> *The Report of the Study Group on Technological Standards and Competition Policy* (July 2001, Study Group on Technological Standards and Competition Policy) states, "Even after technological standards have been established, competition among technologies is not extinguished. Acting to ensure competition with alternative technologies, including next-generation technologies is vitally important. Accordingly, the JFTC must deal strictly and fairly with conduct to obstruct the development, popularization and sale of alternative technologies through the use of exclusive ownership of technological standards."



Specifically such problems are as follows.

**(a) Denial of use of technological standards that correspond to essential facilities, discrimination, and transaction-based restrictions and obligations**

In the course of using technological standards that correspond to essential facilities, when entrepreneurs that independently own, exclusively or in common, essential facilities engage in conduct, either on their own or through related businesses, such as causing disadvantageous transactions against competitors as described below without just cause, this places the competitors in a disadvantageous position and distorts competition in the use market for the technological standards, and the JFTC must deal with such conduct swiftly and effectively under the Antimonopoly Act.

(Example)

- Not adequately disclosing interface information to competitors that wish to provide services using the technological standards that correspond to essential facilities.

**(b) Conduct to use a position of independent ownership, exclusively or in common, of essential facilities to prevent or obstruct the movement of customers to competitors**

In the course of using technological standards that correspond to essential facilities, in some cases an entrepreneur can place competitors in the use market for the technological standards (however, excluding markets to sell the technological standards) in a competitively disadvantageous position, even when its conduct does not amount to discrimination. Specifically, situations can be envisioned where an entrepreneur that independently owns, exclusively or in common, technological standards will prevent or obstruct the movement of customers, by having the division that owns the technological standards in question provide internal assistance to the sales and marketing division in the use market, through conduct such as using its unique position originating in the fact the division owning the technological standards and the sales and marketing division in the use market are identical to prevent or obstruct customers from moving to another company, for example, by enacting policies to keep its own customers from moving to the company in question based on information related to approval for use of the technological standards by competitors, or continually increasing use fees to competitors for the facilities while selling product inexpensively to its own customers.

For example, conduct in the use market for technological standards such as that described below will place competitors in a competitively disadvantageous position and distort competition

in the use market for the technological standards, and the JFTC must deal with such conduct swiftly and effectively under the Antimonopoly Act.

(Example)

- An entrepreneur that owns personal computer OS interface information learns its OS division has disclosed the OS interface information in question to a software development company that is a competitor in the market for software created using the interface information (example: music or graphics software), and uses the information for its software sales division to press users to not purchase the competitor's software.