21 History of General Designations No. 15 and 16 and the Basic Principles of the Regulations of Unfair Trade Practices

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"Interference with transaction" such as preventing the formation of a contract and "interference with internal operation" such as encouraging a stockholder or an officer of a company to divulge secrets are prohibited under the Antimonopoly Act as unfair trade practices (General Designations No. 15 and 16). It is often argued that these types of practices are problems that only bring about private wrongs between two parties in a competitive relationship and they should normally be resolved under the Unfair Competition Prevention Law. However, the earlier studies have yet to give an answer to the question as to why such provisions that regulate these types of practices have been included in the Antimonopoly Act. Taking this question into consideration, this study inquires into the history of Section 5 of the Federal Trade Commission Act of the United States (FTC Act), from which these provisions on unfair trade practices have derived. This study will offer suggestions concerning basic principles of the regulations of unfair trade practices.

Ⅰ Statement of the Problem

The Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade ("Antimonopoly Act") prohibits "unfair trade practices" (Section 19), and authorizes the Japan Fair Trade Commission (JFTC) to designate certain acts as unfair trade practices (Section 2(9)). In accordance with these provisions, the JFTC announced two types of unfair trade practices, *interference with transaction* as General Designation No. 15 and *interference with internal operation* as General Designation No. 16. It is often argued that both *interference with competition* and *interference with internal operation* are problems that only bring about private wrongs between two parties in a competitive relationship and they should normally be resolved under the Unfair Competition Prevention Law. In reality, as if supporting such argument, the act of *encouraging a stockholder or an officer of a company to divulge secrets,* which is included in the category of *interference with internal operation,* is addressed more comprehensively and specifically in the provisions on *protection of trade secrets* under the Unfair Competition Prevention Law.

The earlier studies have yet to give an answer to the question as to why such provisions have been included in the Antimonopoly Act. This report intends to present the history of development of Section 5(a) of the Federal Trade Commission Act of the United States ("FTC Act"), from which the provisions on unfair trade practices have been derived, and the process of introduction of Section 5(a) of the FTC Act into the Antimonopoly Act. The study from such a standpoint will not only clarify the history of General Designations No. 15 and 16, but also give suggestions concerning points of issue in the interpretation of these provisions and basic principles of the regulations of unfair trade practices.

Ⅱ Development of the Regulations under Section 5(a) of the FTC Act

1 Conflict of Views

The initial provision of Section 5(a) of the FTC Act at the time of establishment in 1914 stated that "unfair methods of competition" were illegal, and at that time, there was a conflict of views as to what was meant by the phrase "unfair methods of competition." The following sections present such views that were published rather earlier.

(1) Point of View of William H.S. Stevens [*1]

As to the question of *what is the general criterion for identifying "unfair methods of competition,"* William H.S. Stevens considered as follows: It cannot be helped that organizations that are inferior in economic or production efficiency are eliminated from the market, but in reality, it is often the case that efficient organizations are eliminated, and such practices that eliminate the efficient are regarded as "unfair methods of competition."

Summarizing the above statement, Stevens construed unfair methods of competition as referring to practices that would eliminate organizations that had no problem in terms of efficiency.

Practices that Stevens considered to be subject to Section 5(a) of the FTC Act were as

(*1) William H.S. Stevens, *Unfair Competition* (1917)

follows: local price cutting; operation of bogus independent concerns; fighting instruments; conditional requirements (“tying clauses”); exclusive arrangements; boycotts, etc.; rebates and preferential arrangements; engrossing manufacturing resources; espionage; coercion, etc.; interference; manipulation. What is significant in Stevens’ view to this report, which inquires into the history of General Designations No. 15 and 16, is that Stevens included espionage and interference in the scope of regulation by Section 5(a) of the FTC Act. Espionage means obtaining information in regard to the business of competitors by using spies and detectives or bribing railway and other employees, instead of through ordinary business channels, and it may partly overlap with *interference of internal operation* (General Designation No. 16). Stevens also provided examples of interference, such as following the salesmen of a competitor, solo or in pairs, with an attempt to interrupt the conversation between the competitor’s salesmen and their customers in order to dissuade the customers from purchasing the competitor’s goods, and inducing the breach of contracts, sometimes agreeing to protect violators in case of suit. These practices correspond with “preventing the formation of a contract” and “inducing the breach of a contract,” as examples of *interference with transaction.*

Stevens first presented this view right at the time when the FTC Act was under deliberation in the Congress. His view was referred to in the Congress deliberation, and also in case laws thereafter. However, Stevens’ view is merely one of the views regarding unfair methods of competition, and some people had different views. Among such people, Harlan and McCandless were criticized by Stevens by name.

(2) Point of View of Harlan and McCandless [*2]

The view of Harlan and McCandless can be simply summarized as follows: methods of competition would not be regarded as violating Section 5(a) of the FTC Act unless they are not only unfair and but also lessen competition or create a monopoly, resulting in rigid price and quality.

The Clayton Act, which was enacted concurrently with the legislation of the FTC Act, specifically listed illegal practices, clearly providing that certain practices must substantially lessen competition or tend to create a monopoly as a condition of regarding them as illegal. Though Section 5(a) of the FTC Act did not provide as such literally, Harlan and McCandless tried to justify their view by suggesting three statutory grounds. The first and second grounds are explained in this section, and the third ground will be explained in (3) below.

The first ground is that the statutory proceedings under Section 5(a) of the FTC Act are substantially the same as those under the Clayton Act. Harlan and McCandless argued that it was because the practices to be regulated by the two laws had common natures, that both laws were enforced by substantially the same proceedings. As mentioned above, the Clayton Act clearly provides that certain practices must lessen competition, restrict transactions, and create a monopoly as a condition of regarding them as illegal. In other words, the common natures in the practices prohibited by the Clayton Act are the lessening of competition, restriction of transactions, and creation of a monopoly, and therefore certain practices must have such natures as a condition of regarding them as violating Section 5(a) of the FTC Act.

The second ground presented by Harlan and McCandless is the fact that the majority opinion in the Standard Oil judgment used the phrase “unfair methods of competition” in the same meaning as that employed by them. Though this judgment had been rendered three years before Section 5(a) of the FTC Act was enacted, the phrase “unfair methods of competition” had been used in it. This phrase was also mentioned in the Senate during the deliberation of the bill for the FTC Act.

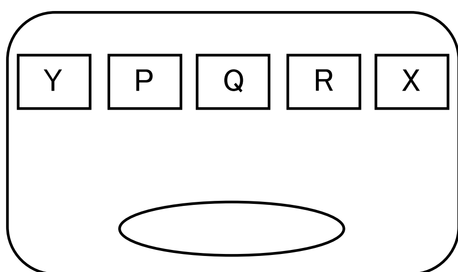
Based on Harlan and McCandless’s view, consisting of the general criterion and its grounds mentioned above, after all, Section 5(a) of the FTC Act did not add a new provision to the existing legal system substantively; it is rather significant in that it increased enforcement proceedings in addition to penal punishments and injunction issued by the Department of Justice, which had been available under the existing legal system.

The types of practices that Harlan and McCandless definitely included in the scope of regulation were: local price cutting; bogus independent companies; full line forcing; boycotts and black lists; and payment of rebates. On the other hand, they stated espionage was “used not as in itself a means of suppressing competition, restraining trade, or acquiring monopoly, but in order to obtain information as a basis to accomplish those ultimate ends by some other methods, as for instance by local price cutting, or exclusive sale arrangements.” This statement may lead to the conclusion that espionage itself, in principle, does not fall under unfair methods of competition. They did not exclude other practices from the scope of unfair methods of competition, such as disparaging the goods of a rival, supplying goods by fraudulent or deceptive means, and sending out false notice that a rival’s goods are made in infringement of a patent and threatening to sue the purchasers of such goods as infringers, if these practices were

(*2) John Maynard Harlan and Lewis McCandless, *The Federal Trade Commission* 115-36 (1916).

employed for the purpose of lessening competition or acquiring market power and found to be highly likely to accomplish such purpose. Nevertheless, they held that these practices would ordinarily result merely in private wrongs.

Comparing Harlan and McCandless's view with Stevens' view, Stevens, without hesitation, mentioned more practices than Harlan and McCandless as candidates of practices to be regulated. This difference seems to be due to the difference in the general criteria that was applied. As competition is lessened and a monopoly is created, an organization that has no problem in terms of efficiency may be eliminated from the market. In other words, all practices that Harlan and McCandless judge to be illegal are always also judged to be illegal by Stevens, but not vice versa. If there are two or more organizations that have no problem in terms of efficiency in the market, the elimination of some of these organizations will not immediately lead to the lessening of competition or creation of a monopoly, or result in rigid price and quality. In the figure shown below, even after X is eliminated, competition might continue to exist with P, Q, and R. Stevens' view may conclude that such elimination would also be regarded as illegal, and Harlan and McCandless's view seems to restrict the scope of illegality.



The conflict between Stevens and Harlan/McCandless was not only seen in regard to unfair methods of competition under Section 5(a) of the FTC Act but also in regard to the interpretation of Section 5(b).

(3) Conflict of Views over Section 5(b) of the FTC Act

Section 5(b) of the FTC Act provided that "whenever the Commission shall have reason to believe that any such person [partnership, or corporation] has been or is using any unfair method of competition, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public," it shall issue and serve upon such person [partnership, or corporation] a complaint.

Harlan and McCandless pointed out the provision of Section 5(b) of the FTC Act as the third ground for justifying their view regarding unfair methods of competition. When enacting the FTC Act, the Congress did not intended to fully delegate the FTC to consider whether regulation of any unfair method of competition was in the interest of the public, because it would raise constitutional questions, but believed that this issue should be considered in accordance with the pre-existing law. The conduct that should be regulated for the public interest under the pre-existing law means conduct that would lead to the lessening of competition or creation of a monopoly.

According to Harlan and McCandless' view, conduct shall not be regarded as illegal unless it is proven that regulation of the conduct would be in the public interest, or in other words, that the conduct would lead to the lessening of competition or creation of a monopoly. On the other hand, Stevens stated that it was unnecessary that the FTC either allege or attempt to prove the existence of public interest. He considered that Harlan and McCandless made a mistake in interpreting Section 5(b) of the FTC Act, and even if a certain conduct fell under the unfair methods of competition, whether or not to proceed against it was left to the discretion of the FTC under the provision of Section 5(b).

Summarizing the discussion so far, Stevens gave a broad interpretation on the phrase "unfair methods of competition" whereas Harlan and McCandless interpreted it narrowly. This difference in interpretation led to a conflict of views as to whether Section 5(b) of the FTC Act was intended to authorize the FTC to exercise its discretion, or intended merely to express the provision of Section 5(a) of the FTC Act in other words.

In light of the academic views presented above, the next section will see the standpoints taken by the FTC and courts, which are in charge of practical operations of Section 5 of the FTC Act.

2 Standpoints of the FTC and Courts

According to the FTC's Annual Reports and judicial precedents [*3], the FTC and courts did not indicate any general formula for the scope of unfair method of competition but they did not seem to limit such scope to practices that would lead to the lessening of competition or creation of a monopoly.

Paying attention to the actual cases, the FTC, when it was inaugurated, regulated a wide variety of practices, which included "interference of conclusion or fulfillment of contracts" and "espionage." However, as these practices were not dealt with so frequently and the FTC's decisions only provided brief explanations, it cannot be sufficiently ascertained whether the FTC intended to regulate them on the ground that they would restrain competition and create a monopoly. The

(*3) Federal Trade Commission v. Keppel, 291 U.S. 304 (1934)

FTC stopped dealing with these practices in the latter half of the 1920s.

During the latter half of the 1920s, the following operational policy and judicial precedents addressing Section 5(b) appeared. In the Annual Report for FY1927, the FTC declared the following operational policy: "It shall be the policy of the commission not to entertain proceedings of alleged unfair practices where the alleged violation of law is a purely private controversy redressable in the courts except where said practices substantially tend to affect the public. In cases where the alleged injury is one to a competitor only and the interest of the public is not substantially involved, the proceeding will not be entertained." As Stevens' view, this operational policy also authorizes the FTC to consider whether to enforce proceedings of alleged unfair practices. However, this policy is different from Stevens' view because Stevens did not seem to hesitate, in his books, in intervening in a dispute between individuals whereas the policy is negative to such intervention.

One of judgments addressing Section 5(b) is Federal Trade Commission v. Klesner, 280 U.S. 19 (1929). This case draws the conclusion that whether regulation of a particular practice is in the "public interest" is a criterion for judicially examining whether the FTC should have proceeded with the complaint concerned.

Five years later in the Keppel Case, the Supreme Court suggested the requirement of "public interest" as follows. The judgment in the Keppel Case is cited below. It is important because it offers suggestions for the Japanese laws.

> The practice is carried on by forty or more manufacturers…Sales of the break and take package by respondent aggregate about $234,000 per year…A practice so generally adopted by manufacturers necessarily affects not only competing manufacturers but the far greater number of retailers to whom they sell, and the consumers to whom the retailers sell. Thus the effects of the device are felt throughout the penny candy industry. A practice so widespread and so far reaching in its consequences is of public concern if in other respects within the purview of the statue.

The circumstances pointed out in this judgment–Keppel's sales amount and the fact that Keppel's practice was adopted by many manufacturers–seem to correspond to "extendibility of the act" under Japanese laws. This point will be examined in Section "IV. Suggestions for the Japanese Laws." These movements were seen in the latter half of the 1920s during which the FTC stopped dealing with complaints about "interference of conclusion or fulfillment of contracts" and "espionage." Since that period until today, there have been further movements concerning Section 5 of the FTC Act, and in particular Section 5(a), but it would be sufficient to grasp the trends mentioned above for the purpose of clarifying the history of General Designations No. 15 and 16. Now, let us see how Section 5(a) of the FTC Act was introduced into the Japanese laws.

Ⅲ Introduction of Section 5(a) of the FTC Act into the Japanese Laws: Draft Designations of 1950

The existing General Designations No. 15 and 16, which regulate *interference with competition* and *interference with internal operation* respectively, were newly established upon legal revision in 1953. At the time of establishment, only a brief explanation was given that these designations were aimed to regulate practices that might be used as the means of taking over a corporation, so as to prevent corporations from being taken by competitors, and how the FTC Act was introduced into the Japanese Antimonopoly Act is unclear.

The author of this report has found a preliminary movement that was intended to introduce these provisions before the legal revision in 1953: announcement of the draft designations in 1950. At that time, "unfair trade practices" were referred to as "unfair methods of competition," and at the beginning of 1950, the JFTC tried to designate the following acts as "unfair methods of competition," though these draft designations were not accepted as formal designations due to strong opposition from the industry.

1. The following acts committed by a company (including a foreign company), thereby interfering in the operation of another Japanese company that is in a competitive relationship with the company in Japan:
   (a)Inducing or coercing a stockholder of another company to follow one's direction, exercise voting rights, or sell or transfer the stock of the company;
   (b)Inducing or coercing an officer or employee of another company to divulge the company's trade secrets, customer lists or other confidential information or to undertake an act that is disadvantageous to the company or not to undertake an act that is advantageous to the company in the course of performing their duties.
   (c)Omitted
2. Omitted
3. Interfering in the fulfillment of contracts between another entrepreneur that is in a competitive relationship with oneself in Japan and its customers, suppliers, agents, or employees, by inducing the breach of such contracts or any other means whatsoever.

These draft designations obviously resemble

the existing designations, though there are minor differences. There was no such explanation that the provisions of the draft designations presented above were aimed to regulate the means of taking over a corporation.

The JFTC official who seems to have played a significant role in preparing the draft designations wrote a paper with the aim of winning understanding of the draft from the public.[*4] This paper implies how the FTC Act was introduced into the Japanese Antimonopoly Act. The statement in this paper that outlines "what is unfair methods of competition" is something like a summary of the contents of Stevens' books. This paper also cites 31 types of practices, from the Annual Report of the Federal Trade Commission for FY1947, referring to them as "practices against which the FTC has issued orders of elimination measures so far."

If it is read taking into consideration the conflict of views mentioned in II above, this paper raises questions as to the author's view concerning the following two points: Harlan and McCandless's view could have been adopted; the FTC, in the latter half of the 1920s, stopped regulating some such practices that the FTC had already regulated. This paper cannot be regarded as providing enough statements to resolve the questions and it is not clear to what extent the draft was elaborated. Nevertheless, when formulating the draft designations of 1950, which are similar to existing General Designations No. 15 and 16, reference was made to the general view that was in line with Stevens', and to the case examples that the FTC had handled in the past nearly forty years.

Ⅳ Suggestions for the Japanese Laws

As a prerequisite to consider what suggestions can be obtained from the history of General Designations No. 15 and 16 studied above, it is necessary to review the current common view of the JFTC concerning unfair trade practices.

As mentioned in the beginning of the report, the authority to designate specific practices as unfair trade practices is vested in the JFTC. The JFTC includes not only *interference with competition and interference with internal operation* but also tying clauses, exclusive arrangements, and predatory pricing (local price cutting is a kind of predatory pricing) in the scope of designations, irrespective of industries. According to the current common view of the JFTC, practices such as tying clauses, exclusive arrangements, and predatory pricing shall be regulated by the same criterion as that adopted by Harlan and McCandless. In other words, these practices shall be regulated because they "tend to impede fair competition in the market (lessen competition)" (It should be noted that the JFTC used the term "tend," which means that it would only require a general or abstract likelihood to impede or lessen competition). On the other hand, the practices regulated by General Designations No. 15 and 16 are considered as a problem because they impede competition that is intensified by providing products or services of a better quality at a lower price. These practices seem to be regulated for a similar reason to that argued by Stevens. This is the summary of the current common view of the JFTC.

There is controversy over the interpretation of General Designations No. 15 and 16. According to the current common view of the JFTC, *interference of transaction or interference of internal operation* that lacks "extendibility of the act" shall not be deemed to be in violation of the Antimonopoly Act. "Extendibility of the act" means the "number of parties affected by an act, and continuity, repetitiveness, and diffusibility of the act." As this "extendibility of the act" is required, where an organization commits an interference of transaction only once against only one trading party and no other organizations follow such an act, the organization shall not be regarded as violating the Antimonopoly Act, even though its act has actually eliminated one competitor. However, there is an opposite view that acts that do not have such "extendibility" shall also be in violation of the Antimonopoly Act and the JFTC's view only means that the JFTC would take no action against such acts. This view is becoming influential recently.

The history of "extendibility of the act" is less clear than the history of *interference with transaction and interaction with internal operation,* and this report is also unable to clarify it. However, both the provision of Section 5(b) of the FTC Act and the FTC's operational policy have also been mentioned in the past studies. As mentioned above, the Supreme Court in the Keppel Case concluded, on the ground of the Keppel's sales amount and the spread of its practice among competitors, that the regulation of Keppel's practice was in the interest of the public. This implies that "extendibility of the act" has also derived from the U.S. laws. "Extendibility of the act" shall be regarded as a

(*4) Shigekazu Imamura, "Fukōsei kyōsōhōhō no kinshi ni tsuite—kōtori no daiichijisitei ni saishite—" (Prohibition of unfair methods of competition: upon the first designations by the JFTC), *Zaiseikeizaikōhō* 178 (1950). Part of this paper was later included in Shigekazu Imamura, *Shitekidokusenkinshihō no kenkyū* (Study on the private monopoly prohibition law) (Yūhikaku, 1956), 112 and afterward. However, due to the deletion of its subtitles, this paper cannot be recognized any more as having been written upon the development of the draft designations in 1950.

factor to be considered by the JFTC when choosing the cases to be handled or a criterion for judicial examination, and therefore, *interference of transaction and interference of internal operation* without "extendibility of the act" shall also be regarded as violating the Antimonopoly Act. This suggestion can be obtained by examining the history of General Designations No. 15 and 16.

If "extendibility of the act" is construed differently from the way it is construed in the current common view of the JFTC, General Designations No. 15 and 16 would appear to be increasingly different from provisions regulating other types of practices. However, what should be recalled in this respect is the fact that Stevens considered all types of practices to be illegal if they would eliminate organizations with no problem in terms of efficiency.

In the United States, it is currently considered as a matter of fact that a practice that will not lead to the creation of a monopoly or lessening of competition does not fall under unfair methods of competition. In other words, the majority currently supports Harlan and McCandless's view. As long as this view is followed, if competition exists with P, Q, and R even after Y requests its trading partners not to have transactions with X and thereby eliminates X, such exclusive arrangement will not be regarded as falling under unfair methods of competition.

However, under the U.S. laws, the following argument may be logically established: it is allowable to broadly construe the scope of unfair methods of competition because, when a practice falls under unfair methods of competition, it would only result in the issuance of orders of elimination measures by the FTC but would not result in penal punishments or triple damages.

In Japan, unfair trade practice will not result in penal punishments or triple damages. Exclusive arrangements are regulated because they tend to impede fair competition, and the use of the term "tend" is construed as meaning that only a general or abstract likelihood to impede or lessen competition is required. Therefore, it is by no means outrageous to draw a conclusion that a practice shall be regarded as "tending to impede fair competition" where the practice has made it difficult for X to continue business operation even if P, Q, and R remain in business.

This conclusion might face an objection that it is inappropriate to adopt a view that is different from the one established under the U.S. antitrust laws, which are the basis of the Antimonopoly Act and have a strong influence globally, but the following points can be suggested against such objection.

Firstly, both the FTC Act and the Clayton Act are "Federal" laws. Though, in Japan, reference is only made to the "Federal" laws in most cases, the U.S. antitrust laws also include similar "State" laws. While Harlan and McCandless' view seems to be supported by "Federal" laws, it is not clear the same shall apply to "State" laws. In this respect, it is pointed out that some "State" laws do not require the lessening of competition or creation of a monopoly as a criterion for identifying illegality to regulate predatory pricing.[*5]

Secondly, in Japan, an injunction may, in principle, only be issued against an act that falls under the category of unfair trade practices under the Antimonopoly Act or acts listed in Section 2(1) of the Unfair Competition Prevention Law. Under such circumstances, if the majority view on the U.S. laws is adopted, an injunction would not be issued against an act that does not result in the lessening of competition or creation of a monopoly and such an act cannot be prohibited unless it falls under the listing in Section 2(1) of the Unfair Competition Prevention Law. On the other hand, in the United States, case laws play quite an important role in unfair competition laws, which seem to be more flexible than the Japanese laws. If the Unfair Competition Prevention Law was flexible, it would not be inappropriate for the Antimonopoly Act to adopt the criterion of "restriction of competition or creation of a monopoly"; however, as it is not, the Antimonopoly Act should adopt certain necessary criteria.

Thus, it is necessary not to pay attention only to the Antimonopoly Act and the FTC Act/Clayton Act but to take a broader perspective. While bearing this in mind, future research should be carried out regarding the basic principle of regulations of unfair trade practices.

(*5) Hiroko Nakagawa, *Fitōrenbai to Nich-Bei-Ō kyōsōhō* (Predatory Pricing and Competition Law in Japan, the United States and the European Community) (Yūhikaku, 2001), 179.