COMMENT OF THE GLOBAL ANTITRUST INSTITUTE, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ON THE QUESTIONNAIRE FOR THE REVISION OF CHINA'S ANTI-MONOPOLY LAW

December 10, 2015

This comment is submitted in response to the China University of Political Science and Law's (CUPL's) Questionnaire for the Revision of the Anti-Monopoly Law (AML). We appreciate the opportunity to comment and commend the CUPL for its commitment to transparency in evaluating potential revision of the AML. We submit this comment based upon our extensive experience and expertise in antitrust law and economics.[1]

This comment responds to select questions from the questionnaire relating to: general principles; vertical restraints; the definition of a dominant market position; the prohibition on purchasing products at "unfairly high" or buying products at "unfairly low" prices; refusing to deal; collective dominance; concentration of undertakings; abuse of administrative power; fines; disgorgement; and Article 55 on the application of the AML to matters involving intellectual property rights (IPRs).

Chapter I. General Principles (Questions 1-4)

As China recently recognized in the Sixth Meeting of the U.S-China Strategic and Economic Dialogue, "the objective of competition policy is to promote consumer welfare and economic efficiency, rather than to promote individual competitors or industries, and . . . enforcement of its competition law should be fair, objective, transparent, and non-discriminatory."[2] In order to bring the AML into conformity with its recent commitments, we respectfully recommend that Article 1 of the AML be revised as follows:

> This Law is enacted for the purpose of preventing and restricting monopolist conducts, protecting ~~fair~~ <u>undistorted</u> market competition, ~~and~~ enhancing economic efficiency, <u>and promoting consumer welfare</u> ~~safeguarding the interests of consumers and the interests of the society as a whole, and promoting the healthy development of the socialist market~~

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[2] Press Release, U.S. Dep't of Treasury, Sixth Meeting of the U.S.-China Strategic and Economic Dialogue U.S. Fact Sheet—Economic Track (July 11, 2014), https://www.treasury.gov/press-center/press-releases/Pages/jl2563.aspx.

~~economy~~.

Similarly, we also respectfully recommend that Article 4 be revised as follows:

The State shall formulate and implement competition rules that are compatible with promoting consumer welfare and economic efficiency ~~the socialist market economy, in order to improve macro-economic regulation and build up a sound market network that operates in an integrated, open, competitive, and orderly manner~~.

Experience has taught us that robust and undistorted competition produces substantial benefits for consumers and society as a whole by promoting growth, spurring innovation, and facilitating the efficient allocation of resources. It has also taught us that competition law and policy is most effective when it focuses exclusively upon competition and consumer welfare rather than attempting to achieve simultaneously multiple goals, some of which may be in conflict with others.

Indeed, economies with competitive domestic markets tend to have higher levels and rates of growth per capita income,[3] and industries with greater competition experience faster productivity growth.[4] Competition in the domestic market creates efficient, productive firms that are better able to compete on global markets, which in turn increases economic growth and standards of living.[5] A competitive market also enhances the innovative efforts of a society.[6] "A

[3] *See, e.g.*, R.S. Khemani, *Competition Policy and Promotion of Investment, Economic Growth and Poverty Alleviation in Least Developed Countries* 3 (The World Bank, Occasional Paper No. 19, 2007), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/11/07/000020953_20071107085243/Rendered/PDF/413340FIAS1Competition1Policy01PUBLIC1.pdf; WORLD BANK, GLOBAL ECONOMIC PROSPECTS AND THE DEVELOPING COUNTRIES (2003), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2003/02/15/000094946_03013104005941/Rendered/PDF/multi0page.pdf.

[4] ORG. FOR ECON. CO-OPERATION & DEV. [OECD], FACTSHEET ON HOW COMPETITION POLICY AFFECTS MACRO-ECONOMIC OUTCOMES 4-5 (2014), http://www.oecd.org/daf/competition/2014-competition-factsheet-iv-en.pdf [hereinafter OECD FACTSHEET] (collecting studies); *see also e.g.*, Stephen J. Nickell, *Competition and Corporate Performance*, 104 J. POL. ECON. 724, 740 (1996) (finding that most competitive firms experienced productivity growth rates 3.8-4.6% higher than the least competitive); Paolo Buccirossi et al., *Competition Policy and Productivity Growth: An Empirical Assessment*, 95 REVIEW OF ECON. & STATISTICS 1324 (2013) (a study of 22 industries in 12 OECD countries linked the quality of competition policy and productivity, finding, among other things, that about one-fifth of industry productivity growth in a reforming economy (the UK) could be attributed to competition policy improvements); Chang-Tai Hseih & Peter J. Klenow, *Misallocation and Manufacturing TFP in China and India*, 124 Q. J. OF ECON. 1403, 1405 (2009) (finding that total factor productivity in India and China could be 50% higher, without technical change, through greater competition).

[5] *See* OECD FACTSHEET, *supra* note 4, at 11 (collecting studies); *see also* J.M. Arnold et al., *Regulation, Resource Reallocation and Productivity Growth*, 16 EUROPEAN INVESTMENT BANK [EIB] PAPERS, no. 1, 2011, at 90, http://www.eib.org/attachments/efs/eibpapers/eibpapers_2011_v16_n01_en.pdf [hereinafter Arnold et al.] (finding that productivity growth is largely driven by reallocation from less to more productive firms).

market mechanism achieves much of its efficiency and its adaption to consumer desires through financial incentives, by providing higher payoffs to those firms that are more efficient and whose products are most closely adapted to the wishes of consumers. The same mechanism obviously drives innovation in an even more powerful way. For oligopoly firms in high-tech sectors of the economy, it is in fact a matter of survival. The firm that lets its rival outperform it substantially in innovative products and processes is faced with the prospect of imminent demise."[7]

Studies such as the McKinsey Global Institute's survey of the economic performance of thirteen nations further support this assessment.[8] The McKinsey survey supports the consensus view among economists that productivity makes a crucial difference in economic development and that the presence or absence of undistorted competition among firms is critical to productivity. When competition is distorted, firms that fail to meet the demands of the market to produce what consumers want at competitive prices are not pressured to either improve or to exit the market. As a result, an entire economy becomes less competitive. Investment lags, jobs are more scarce, goods and services are more expensive, and more of what consumers spend goes to enriching monopolists instead of their own lives.

In addition, the use of non-competition factors in competition analysis raises a number of other concerns, such as the difficulty of balancing competition and non-competition factors across different markets and balancing efficiency concerns against equity concerns; the likelihood that public policy issues may undermine consumer welfare considerations; the likelihood of undermining clarity and predictability in antitrust enforcement; and the lack of expertise by competition officials to weigh non-competition factors.[9] Indeed, the failed experiment of the United States in seeking to use its antitrust laws to serve a hodgepodge of social and political goals, many with an explicitly anticompetitive bent such as protecting small traders from more efficient rivals, resulted in the general failure of U.S. antitrust laws to promote competition or further consumer welfare. This ended in the 1970s when the U.S. Supreme Court

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[6] *See, e.g.*, R. Hewitt Pate, Assistant Attorney General, Antitrust Division, U.S. Dep't of Justice, *Promoting Economic Growth and Innovation*, Address before the Chinese Academy of Social Sciences, Institute of Law (July 1, 2004), http://www.justice.gov/atr/speech/promoting-economic-growth-through-competition-and-innovation.

[7] WILLIAM J. BAUMOL, THE FREE-MARKET INNOVATION MACHINE: ANALYZING THE GROWTH MIRACLE OF CAPITALISM 10 (Princeton Univ. Press 2002) [hereinafter BAUMOL].

[8] *See, e.g.,* WILLIAM W. LEWIS, THE POWER OF PRODUCTIVITY: WEALTH, POVERTY, AND THE THREAT TO GLOBAL STABILITY 13 (2004).

[9] *See* Edith Ramirez, Chairwoman, Fed. Trade Comm'n, *Core Competition Agency Principles: Lessons Learned at the FTC*, Keynote Address at the ABA's Antitrust in Asia Conference 2 (May 22, 2014), http://www.ftc.gov/system/files/documents/public_statements/314151/140522abachinakeynote.pdf; *see also* Joshua D. Wright & Douglas H. Ginsburg, *The Goals of Antitrust: Welfare Trumps Choice*, 81 FORDHAM L. REV. 2405 (2013) [hereinafter Wright & Ginsburg]; Koren W. Wong-Ervin, *The Importance of Procedural Fairness and of Focusing Solely on Competition Factors in Competition Analysis*, ABA INT'L ANTITRUST BULL. (Aug. 2014), https://www.ftc.gov/system/files/attachments/key-speeches-presentations/wong-ervin_-_procedural_fairness_-_aug_2014.pdf.

shifted the focus of U.S. antitrust law from a mix of economic, social, and political goals to solely economic goals.[10]

Lastly, Article 7 provides, in relevant part, that "with respect to the industries that are under the control of the State-owned economic sector that have a bearing on the lifeline of the national economy or national security and the industries that exercise monopoly over the production and sale of certain commodities according to state law, the State shall protect the lawful business operations" of such undertakings. We respectfully urge that this provision be omitted entirely or, at the very least, revised so that state-owned enterprises (SOEs) are not exempt from the AML other than the protections afforded by Article 7 of China's Constitution (which provides, in relevant part, that "[t]he state ensures the consolidation and growth of the state economy," i.e., "the sector of socialist economy under ownership by the whole people"). "[A]pplying the AML [to State monopolies] does not mean a challenge to the constitutional privilege of those enterprises but, rather, it sets limits to which that privilege can be exercised, such as refraining from abusing a State-granted dominant position."[11]

Conferring upon SOEs privileges and immunities that are not available to their privately-owned competitors, or based on superior performance or efficiency, distorts competition in the market between state-owned and privately-owned rivals.[12] In addition, in general, SOEs are not as efficient as privately-owned firms given that, unlike private firms, which are generally driven by profit, SOEs may have a number of other objectives including employment, social goals, or wealth distribution. Use of SOEs to achieve non-market goals is generally a costly way to achieve such goals. These incentives can significantly affect their performance in the market and unnecessarily increase the costs of producing these goals.[13] SOEs also generate increased agency problems relative to privately owned firms. The incentives of managers of SOEs are less aligned with those of the general public given the absence of the types of market incentives used to align the interest of the firm with that of its shareholders.[14] As a result, the decision-making in private firms tend to be less burdensome than in SOEs, and there is more accountability based on the outcome of such decisions.[15] Indeed, managers in SOEs are less likely to be dismissed for poor performance and the state is more likely to provide financial assistance to a mismanaged SOE than a privately-owned firm.[16]

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[10] Wright & Ginsburg, *supra* note 9, at 2405-06.

[11] Yong Huang, *Pursuing the Second Best: The History, Momentum, and Remaining Issues of China's Anti-Monopoly Law,* 75 ANTITRUST L.J. 117, 128 (2008) [hereinafter Yong Huang].

[12] *See, e.g.*, COMPETITION COMM., OECD, POLICY ROUNDTABLES: STATE OWNED ENTERPRISES AND THE PRINCIPLE OF COMPETITION NEUTRALITY 25 (2009), http://www.oecd.org/daf/competition/46734249.pdf.

[13] *Id.* at 28.

[14] *Id.* at 29 (internal citation omitted).

[15] *Id.*

[16] *Id.* at 30 (collecting cites).

Chapter II. Monopoly Agreements—Vertical Restraints (Questions 5-6)

We respectfully recommend that, should the AML be revised to add a specific provision governing vertical restraints, the provision should explicitly recognize that the vast majority of such restraints are either procompetitive or benign and as such should be analyzed under the rule of reason, or an effects-based approach in which restraints are condemned only when any anticompetitive harm they cause outweighs any procompetitive benefits they create. We also recommend that any such provision include a safe harbor for vertical restraints imposed by entities that do not have market power (or a dominant market position).

Economic learning has taught that vertical restraints (which include vertical territorial restrictions, resale price maintenance, exclusive dealing, loyalty discounts, tying, and other related business practices) rarely harm competition and often benefit consumers by reducing price, increasing demand, and/or creating a more efficient distribution channel.[17] As the U.S. Federal Trade Commission's Director of the Bureau of Economics explained, "it appears that when manufacturers choose to impose [vertical] restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision."[18]

To assess the competitive effects of a vertical restraint, as with any antitrust analysis, one must compare the world with the restraint (which is observed) to the world without the restraint (which typically is not observed). The critical element of this analysis is to properly specify the "counterfactual"—that is, the world without the restraint. Economic analysis provides important tools to help competition agencies and courts with this fundamental comparison. In general, it is possible to draw inferences about the unobserved state of the world in either of two ways. First, if a "natural experiment" mimics the effect of the restraint and other factors that might affect price, output, or other variables can be held constant, then it is possible to estimate the competitive effects of the restraint by comparing a control group (without the restraint) to an experimental group (with the restraint). Second, it is possible to use a theoretical economic model of competition among firms to infer the competitive impact of the restraint when one cannot measure it directly.

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[17] *See, e.g.*, James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 642, 658 (2005) [hereinafter Cooper et al.] (surveying the empirical literature, concluding that although "some studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition," and, "in most of the empirical studies reviewed, vertical practices are found to have significant pro-competitive effects"); Daniel O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, *in* THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 72-73 (2008) ("[W]ith few exceptions, the literature does not support the view that [vertical restraints] are used for anticompetitive reasons" and "[vertical restraints] are unlikely to be anticompetitive in most cases."); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005); Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding*, 76 ANTITRUST L.J. 431 (2009).

[18] Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008).

However, a significant difficulty in relying principally upon theoretical models to infer competitive effects in the context of vertical restraints is that the conditions necessary for vertical restraints to harm welfare generally are the same conditions under which the practices increase consumer welfare. For example, pre-existing market power typically is necessary for vertical integration to raise price to unintegrated levels; but vertical integration under these conditions normally would also eliminate double-marginalization,[19] which is procompetitive and generally results in higher output, lower prices, and increased consumer welfare. As such, given the state of economic learning regarding the competitive effects of vertical restraints (i.e., that they rarely harm competition and often benefit consumers), reliance on theoretical models alone to infer competitive harm should generally be insufficient to satisfy the heavy burden on the plaintiff (or government) to prove that a particular restraint is anticompetitive.[20]

Chapter III. Abuse of Market Dominant Position—Charging "Unfairly high" or Buying at "Unfairly Low" Prices, Refusal to Deal, and Collective Dominance (Questions 1-3)

As a threshold matter, we respectfully urge that the definition of a market dominant position in Article 17 be revised to clarify that an entity will only be found to have a dominant market position if it is able to profitably maintain market prices above or market output below competitive levels for a significant period of time.

It is worth noting that there has been a movement in the United States away from focusing upon market definition and market power to infer competitive effects. In particular, the U.S. antitrust agencies increasingly have shifted their focus to a direct assessment of incentives and competitive effects, as evidenced by the 2010 Horizontal Merger Guidelines, and away from using market shares to predict whether a firm possesses market power or is likely to increase prices. This shift in antitrust analysis is consistent with modern economics and is particularly important in matters involving IPRs; IPR holders may need relatively high margins (prices above marginal cost) merely to recoup their upfront investment and compensate for the substantial risks associated with seeking to create and commercialize intellectual property. Prices well above their low or even zero marginal cost are normal features of competitive markets in such industries. In other words, a price above marginal cost in such an industry may result in no more

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[19] Double-marginalization, also known as the problem of successive monopoly, refers to the situation when two firms, each with market power at different vertical levels in the supply chain, individually set prices (or quantities) for complementary goods or services. The result is that both firms set prices at a mark-up over marginal cost, which yields deadweight loss that occurs twice. One way of avoiding the deadweight losses due to double marginalization is by vertically integrating the two firms, thereby eliminating one of the deadweight losses.

[20] *See* Cooper et al., *supra* note 17. For a discussion of the proper analysis of tying arrangements and exclusive dealing, see Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, *in* THE LAW AND ECONOMICS OF ANTITRUST (Keith Hylton ed., Edward Elgar Publishing Ltd. 2009); for loyalty discounts, see Derek W. Moore & Joshua D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 GEO. MASON L. REV. 1205 (2015); Benjamin Klein, *Exclusive Dealing As Competition for Distribution "On The Merits*,*"* 12 GEO. MASON. L. REV. 119 (2003); Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008).

than the competitive rate of return on the investment necessary to create the IPR.[21] Relatedly, the lines between markets may be not be clearly delineated in high-tech markets involving IPRs. To infer a firm has market power based merely upon its high market share or its ability to charge a price greater than marginal cost is to invite frequent errors.

With respect to Article 17(1), which prohibits selling products at "unfairly high" or purchasing products at "unfairly low" prices, we respectfully urge that this provision be deleted in its entirety or, at the very least, revised to explicitly provide an exception for matters involving IPRs.

Price regulation risks punishing vigorous competition. In general, competition policy should not prohibit an entity from charging whatever price for its products and services it believes will maximize its profits. As we explained in our comments on Chapter I, above, markets achieve efficiency through incentives and the ability to flexibly adapt to ever-changing market conditions and consumer preferences. Firms that adapt and innovate to satisfy consumer demand are rewarded with higher payoffs in the form of greater economic profits. Government-mandated prices are necessarily less flexible than market prices. Thus, imposed prices that are too high or too low encourage misallocation of resources, soften incentives to engage in efficient conduct, reduce incentives to innovate, and distort markets.[22] The ability of prices to change to reflect demand and supply conditions is well understood by economists to lie at the center of the causal relationship between markets, productivity, and growth. "Price legitimately plays an important role in the central economic models: as a conduit of information to the market it is an indispensable variable of general equilibrium theory."[23] Most markets are competitive and monopoly tends to be self-correcting. But even when markets are not competitive, the costs of price regulation are likely to outweigh its benefits.[24] Indeed, excessive pricing cases are considered to be among the most difficult and complex cases for competition authorities in terms of standards for assessment, analysis of data, and the design and implementation of suitable remedies. These difficulties create a substantial risk of both Type I (false positives) and Type II (false negatives) errors.

In the United States, the antitrust laws incorporate these concerns. Firms are free unilaterally to set or privately to negotiate their prices, and even a monopolist is free to charge the highest price that it can obtain for its goods and services, which rewards the risk-taking and entrepreneurial behavior by firms that lead to innovation and economic growth.[25] As the U.S. Supreme Court explained in *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko*, *LLP*:

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[21] *See generally* Benjamin Klein & John Shepard Wiley Jr., *Competitive Price Discrimination As An Antitrust Justification for Intellectual Property Refusals to Deal*, 70 ANTITRUST L.J. 599 (2003).

[22] *See generally* F.A. Hayek, *Competition as a Discovery Procedure*, 5 THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS 3, 13 (2002).

[23] Baumol, *supra* note 7 at 15.

[24] *See, e.g.*, Michal Gal, *Monopoly Pricing as an Antitrust Offense in the U.S. and the EC: Two Systems of Belief About Monopoly?*, THE ANTITRUST BULLETIN 343, 353 (Apr. 2004).

[25] *See, e.g.*, Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

> The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*.[26]

This is especially so in the case of IPRs; the very purpose for which nations create and protect IPRs is to induce investment in risky and costly research and development. To achieve a balance between innovation and the protection of competition, monopoly prices should only be unlawful if they are the result of conduct that is unlawful on other grounds.

Moreover, as discussed, economics teaches that absent market information it can be especially difficult to identify a "fair" price. Indeed, it is particularly difficult to assess the "fairness" of prices associated with licensing IPRs both because there is no marginal cost to which the price may be compared, and because IPRs themselves are highly differentiated products making price comparisons difficult, if not impossible. The risk of placing too strict limitations on intellectual property prices is that the return to innovative behavior is reduced, and consumers suffer in the form of less innovation. With such limits in place, IPRs holders will face significant uncertainty in determining whether their licensing practices violate the AML.

In addition, in order to determine whether a particular price is excessive or unreasonable, the competition agency would need to calculate a reasonable price as a baseline against which to compare the allegedly excessive price. In our experience, competition agencies are generally ill-equipped to calculate rates, a task that is best left to the market or, as a last resort, to the courts.[27]

With respect to Article 17(3), which prohibits a dominant firm from "refusing to transact with counter-parties to a transaction without any justification," we respectfully urge that this provision be revised to limit any liability to conduct that creates or maintains a monopoly. Without such a limitation, Article 17(3) could be interpreted to impose an antitrust-based duty to deal on firms, to micromanage the terms of trade between firms, and to require courts and agencies to administer a burdensome remedy with substantial risk of causing more harm to competition and to consumers than benefits. In light of these risks, the U.S. Supreme Court explained in *United States v. Colgate & Co.*, that "[i]n the absence of any purpose to create or maintain a monopoly, [U.S. antitrust law] does not restrict the long recognized right of [a seller] . . . to exercise his own independent discretion as to parties with whom he will deal."[28] As the Court recently explained in *Trinko*, the rationale behind this rule includes the "uncertain virtue of

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[26] *Id.*

[27] For a discussion of the difficulties of court-determined rate setting, see Anne Layne-Farrar & Koren W. Wong-Ervin, *Methodologies For Calculating FRAND Damages*, LAW 360 (Oct. 8-10, 2014), https://www.ftc.gov/system/files/attachments/key-speeches-presentations/wong-ervin_-_methodologies_for_calculating_frand_damages.pdf.

[28] 250 U.S. 300, 307 (1919); *see also Trinko*, 540 U.S. at 408.

forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm."[29]

Although a firm's competitors may desire to use a particular good or technology in their own products, there are few situations, if any, in which access to a particular good or technology is necessary to compete in a market. Indeed, those who advocate forced sharing often have underestimated the ability of a determined rival to compete around the facility, with resulting benefits to consumers. This is particularly true with respect to fast moving technologies, where technological and market developments can present multiple opportunities to work around a competitor's good or intellectual property. Recognizing these concerns, the U.S. Supreme Court has made it clear that courts should be very cautious in recognizing exceptions to the general rule that even monopolists may choose with whom they deal.[30]

The U.S. approach recognizes that potential inventors may be less likely to undertake the research and development that lead to an invention if the inventor's reward for its efforts is reduced by having to share its technology or goods. Conversely, if businesses know they can easily gain access to the goods or technology of other firms, then they have less incentive to innovate and more incentive instead to free-ride on the risky and expensive research of others.[31] Requiring businesses to transact with competitors is likely to result in less innovation, which will harm consumers in the long run.

With respect to Article 19, which provides market share shares above which a dominant position would be presumed, we respectfully urge that this provision be omitted in its entirety. Specifically, Article 19(1) provides that if a firm has a market share of 50 percent or more, it may be presumed to have a dominant market position. Most importantly, the adoption of market share-based presumptions discourages more rigorous effects-based economic analyses of the restraint at issue in favor of relying upon easier to apply but less accurate forms of analysis. Further, the experience in the United States counsels that a market share of 50 percent is too low to provide a firm with monopoly power, and that even when a firm has a high market share (e.g., above 60 or 70 percent), whether the firm has a dominant market position is a fact-specific issue that must be analyzed on a case-by-case basis. Such an analysis includes an examination of barriers to entry, the likelihood of leapfrog competition, and the durability of high market shares to determine whether the firm actually has the power to profitably maintain prices above or output below competitive levels for a significant period of time.

Article 19(2)-(3) provide for presumptions concerning collective dominance. Such a presumption may harm rather than promote competition. For example, treating the second and third largest firms in a market as dominant firms is likely to deter them from competing aggressively against the market leader, which is likely to harm competition given that they are often in the best position to compete most effectively against the market leader. As such, we respectfully urge that this provision be omitted in its entirety, or at the very least, revised to

[29] 540 U.S. at 408.

[30] *See id.*

[31] *See id.*

require concerted action as a joint monopoly, which is the approach generally required by the European Commission.

Chapter IV. Concentration of Undertakings

We respectfully recommend that Article 20, which defines concentration of undertakings, be revised to define the phrases "control over other undertakings" and "the ability capable of exerting a decisive influence . . . by virtue of contract or any other means."

We also respectfully recommend that Article 21, which sets forth a mandatory premerger approval process, be revised to provide an exemption for transactions that do not have a material nexus with China based on objectively quantifiable criteria such as sales or assets in China. As the International Competition Network has recommended, "[n]otification should not be required unless the transaction is likely to have significant, direct, and immediate economic effect" within the jurisdiction as measured by significant local activities by each of at least two parties to the transaction or by the acquired business.[32] Such revisions will provide transparency and predictability for stakeholders and allow the Ministry of Commerce (MOFCOM) to focus on transactions that are most likely to raise potential competition concerns, and to avoid unnecessary transaction costs and the commitment of agency resources without any corresponding enforcement benefit.

Article 24(5) provides that one of the factors that "shall" be taken into consideration when determining whether to approve a concentration of undertakings is "the impact of their concentration on the development of the national economy." Similarly, Article 28 provides, in relevant part, that when a concentration leads or may lead to the elimination or restriction competition, if the undertakings prove that "the concentration is in the public interest," MOFCOM may decide not to prohibit the concentration. For the reasons set forth in Chapter I, above, in our discussion of the use of non-competition factors, we respectfully urge that these provisions be omitted.

Chapter V. Abusing Administrative Power to Eliminate and Restrict Competition

Chapter V, among other things, wisely prohibits administrative departments from enacting regulations that would eliminate or restrict competition. However, "Article 51 adds a provision that could detract from the clarity of the main provision"[33]:

> If administrative agencies and organizations empowered by laws and regulations to have the function of administrating public affairs abuse their administrative power and engage in activities eliminating or restricting competition, their superior authority shall order them to make corrections. The officials and other personnel who are directly responsible for such activities shall be punished by law. The Anti-monopoly Enforcement

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[32] *See, e.g.*, INT'L COMPETITION NETWORK, RECOMMENDED PRACTICES FOR MERGER NOTIFICATION PROCEDURES, http://www.internationalcompetitionnetwork.org/uploads/library/doc588.pdf.

[33] Yong Huang, *supra* note 11, at 149.

Agency shall provide the superior authority with advice as to how such officials or personnel should be punished by law.

This provision is problematic as written because the "superior authority," which could be any type of agency, likely lacks the expertise and experience to determine whether a particular activity eliminates or restrict competition. Moreover, having numerous agencies interpret the AML is likely to result in conflicting decisions that would create costly confusion and uncertainty for stakeholders. In addition, it is "difficult for a superior agency to keep a neutral attitude in a dispute between its inferior agency and the non-State-owned enterprises or competitors from another region."[34] As such, we respectfully recommend that this provision be omitted in its entirety and that the AML agencies be permitted to enforce the AML against administrative monopolies, including issuing findings of liability, requiring the discontinuation of any violations, confiscating unlawful gains, and/or imposing relevant fines.

In discussing this topic, it is worthwhile to discuss the economics of regulation, namely regulatory capture and public choice. The theoretical basis for economic regulation rests on the idea that regulation *may* be necessary to correct a definable market failure (such as the misallocation of resources) in a particular industry. Of course, there are multiple ways to solve this problem other than resorting to regulation, including private ordering. Successful identification of a market failure is a necessary but not sufficient condition to justify regulation on economic grounds. Once a market failure has been identified, the proposed regulatory solution must itself survive a rigorous economic cost-benefit analysis, one that factors in the potential for unintended consequences.[35]

Beginning in the 1950s, economists began to question whether the regulations observed in practice corresponded with the economic basis for regulating industries. The conclusions were stark. For example, in 1974, Richard Posner (now-Judge Posner for the U.S. Court of Appeals for the Seventh Circuit) observed that "[s]ome fifteen years of theoretical and empirical research, conducted mainly by economists, have demonstrated that regulation is not positively correlated with the presence of external economies or diseconomies with monopolistic market structure."[36]

Economists also developed robust evidence that regulation often benefitted producers and harmed consumers.[37] In monopolistic industries, there was evidence that regulation failed to solve the conflict between allocative and producer efficiency and did not keep prices below monopoly levels. In more competitive industries, there was evidence that regulation supported prices above costs and prevented new firms from entering the market, thereby distorting

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[34] *Id.*

[35] *See* Joshua D. Wright, Commissioner, Fed. Trade Comm'n, *Regulation in High-Tech Markets: Public Choice, Regulatory Capture, and the FTC*, Remarks at the Big Ideas about Information Lecture (April 2, 2015), https://www.ftc.gov/system/files/documents/public_statements/634631/150402clemson.pdf.

[36] Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335, 336 (1974).

[37] *See, e.g.*, William A. Jordan, *Producer Protection, Prior Market Structure, and the Effects of Government Regulation*, 15 J.L. & ECON. 151 (1972).

competition. A recent study found that a substantial easing (one standard deviation) in anticompetitive regulation can raise the productivity growth rate by over one percent, leading to productivity at least ten percent higher over the long run.[38] In addition, the efficiency losses from rent-seeking efforts by market participants to influence regulation go beyond the deadweight loss associated with the creation of entry barriers. These activities also siphon resources from productive to redistributive uses as long as it is possible to use government to gain a monopoly.

With regard to regulators' motivation, Nobel Laureate James Buchanan and Gordon Tullock developed "public choice" economics to help explain why legislators and regulators performed in ways that did not necessarily benefit a majority of consumer-voters. Pubic choice economists observed three important facts about regulation: (1) regulatory legislation redistributes wealth; (2) the behavior of legislators is driven by their desire to remain in office, which means that legislation is designed to maximize political support; and (3) interest groups compete by offering political support in exchange for favorable legislation. Considering these facts together, "[t]he general result that follows is that regulation is likely to be biased toward benefitting interest groups that are better organized . . . and gain more from favorable legislation[, and] is likely to benefit small interest groups with strongly felt preferences at the cost of large interest groups with weakly felt preferences."[39]

These insights help us understand the related concept of regulatory capture, which posits that regulation is either "supplied in response to the industry's demand for regulation (in other words, legislatures are captured by the industry) or the regulatory agency comes to be controlled by the industry over time (in other words, regulators are captured by the industry)."[40]

Public choice and regulatory economics provide insights into the causes of the observed fact that regulation often favors producers rather than consumers. Public choice economics, regulatory economics, and the history of regulation in the United States also offer many lessens to the modern regulator. First, public restraints are especially pernicious for consumers and an especially worthy target for competition agencies. Second, regulators and competition enforcers should use all of their available tools to fight restraints of trade, and in particular competition enforcement, which has enormous deterrent potential. Third, there should be a strong but rebuttable presumption against regulation favoring incumbents over new entrants or accepting invitations from disgruntled firms to have the competition agencies sue their rivals.

Chapter VII. Legal Liabilities—Fines and Disgorgement

Article 47 provides that, "[w]here an undertaking, in violation of the provisions of the [AML], abuses its dominant market position, [the AML agencies] shall instruct it to discontinue such violation, confiscate its unlawful gains, and impose on it a fine of not less than one percent but not more than 10 percent of its sales achieved in the previous year." We respectfully urge that this article be revised to: (1) omit the requirement that either disgorgement or a minimum

[38] Arnold et al., *supra* note 5.

[39] W. KIP VISCUSI ET AL., ECONOMICS OF REGULATION AND ANTITRUST 382 (4th ed. 2005).

[40] *Id.* at 379-80.

fine be imposed; (2) specify that "sales" is limited to sales directly obtained in the relevant product and geographic market in China affected by the violation; and (3) state that the AML agencies will pursue disgorgement only against naked price-fixing agreements among competitors or, in the case of unilateral conduct, only if the dominant firm's conduct has no plausible efficiency justification.

The third revision is necessary to ensure that, in the context of conduct that can be efficient and benefit consumers in some contexts and harm competition and consumers in others (e.g., vertical restraints imposed by a firm with market power), competition enforcers do not deter efficient conduct that would otherwise benefit consumers.[41] Matters involving vertical restraints present the most difficulty in distinguishing between anticompetitive and procompetitive conduct and, as such, are generally inappropriate candidates for disgorgement.

Chapter VIII. Supplementary Articles—
Article 55 on the Application of the AML to IPRs (Questions 5)

We respectfully recommend that Article 55 be revised as follows:

> This Law [the AML] is not applicable to undertakings who exercise their intellectual property rights in accordance with the laws and administrative regulations on intellectual property rights<u>, which includes the right to exclude</u>; however, the Law shall be applicable to undertakings who eliminate or restrict market competition by abusing their intellectual property rights. <u>This Article does not create a standalone violation for the abuse of intellectual property rights. Conduct will only be found to violate this Law if it constitutes a violation of Articles 13 or 14.</u>

Economic literature shows that IPRs—a central feature of which is the right to exclude—incentivize the creation of inventions, ideas, and original works.[42] They also facilitate the sale and licensing of intellectual property (IP) by defining the scope of property right protection and lowering transaction costs, and they produce incentives to develop alternative technologies as well as improvements and other derivative uses.

The incentive function of IP is illustrated by considering the sale of an invention in the absence of enforceable IPRs. The sale of an invention requires disclosure to the potential buyer. In the absence of enforceable IPRs, the potential buyer—now with knowledge of the invention—

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[41] Joshua D. Wright, Commissioner, Fed. Trade Comm'n, *The Federal Trade Commission and Monetary Remedies*, Remarks at the 18th Annual Competition Law and Policy Workshop European University Institute Department of Law 4-5 (July 19, 2013), https://www.ftc.gov/sites/default/files/documents/public_statements/federal-trade-commission-monetary-remedies/130719monetaryremedies.pdf.

[42] *See* Bruce H. Kobayashi & Joshua D. Wright, *Intellectual Property and Standard Setting*, *in* ABA HANDBOOK ON THE ANTITRUST ASPECTS OF STANDARD SETTING 1, 2 (2010) (citing William M. Landes & Richard A. Posner, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW (2003)) [hereinafter Kobayashi & Wright]; Henry E. Smith*, Intellectual Property as Property: Delineating Entitlements in Information*, 116 YALE L.J. 1742 (2007).

has no incentive to purchase or license the invention. This possibility deters the seller from disclosing the invention in the first place. Enforceable property rights solve this problem by allowing the seller to disclose the invention without fear that it will be lawfully appropriated without compensation. The inventor can anticipate the ability to appropriate the returns from investment in producing the invention, which serves as an incentive to invest in producing and to disclose the invention in the first place.

The economic literature also focuses on the related issue of the optimal tradeoff between these incentives and the ability to use the invention.[43] Because inventions and works protected by IPRs are non-rivalrous, one firm using a specific IPR does not diminish the ability of another firm to use the same IPR. Also, the cost of having another firm use an existing IPR is effectively zero. As a consequence, from a static welfare perspective, it is desirable to disseminate IPRs to every firm (or consumer) that has a positive valuation for the IPR. Of course, doing so would create a strong disincentive to innovate in the first place, to the great detriment of dynamic efficiency, which refers to the gains that result from entirely new ways of doing business. While static efficiency may increase consumer welfare in the short run, economics teaches us that dynamic efficiency, including societal gains from innovation, are an even greater driver of consumer welfare.[44]

After the investments and competitive effort required to spur breakthrough inventions have been made and proven successful, it can be tempting to carve up the benefits and distribute them throughout the economy. Doing so, however, would harm competition, innovation, and consumers. If the government is too willing to step in and appropriate the gains from innovation and dynamic competition, then potential innovators anticipating such interventions will have weak incentives to risk investment in new inventions. Likewise, if the laws governing abuse of IPRs is uncertain or unpredictable (which they would be if the prohibition of "unfairly high pricing" is applied to IPRs), potential innovators will also have weak incentives to innovate.

Conclusion

We appreciate the opportunity to comment and would be happy to respond to any questions the CUPL may have regarding this comment.

[43] Kobayashi & Wright, *supra* note 42.

[44] Robert Solow won the Nobel Prize in economics for demonstrating that gains in wealth are due primarily to innovation—not to marginal improvements in the efficiency of what already exists. *See* Press Release, The Royal Swedish Academy of Sciences, The Alfred Nobel Memorial Prize in Economic Sciences 1987 (Oct. 21, 1987), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1987/press.html.