COMMENT OF THE GLOBAL ANTITRUST INSTITUTE, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ON THE PROPOSED REVISIONS TO THE PEOPLE'S REPUBLIC OF CHINA ANTI-UNFAIR COMPETITION LAW

March 24, 2016

This comment is submitted in response to the Legislative Affairs Office of the State Council of the People's Republic of China's public consultation on the draft revisions to the Anti-Unfair Competition Law (AUCL). We submit this comment based upon our extensive experience and expertise in antitrust law and economics.[1]

For the reasons set forth below, we respectfully recommend that any provisions in the AUCL that relate to conduct covered by traditional antitrust laws, or conduct covered by China's Anti-Monopoly Law, be either omitted entirely or revised to limit liability to situations when there is substantial evidence of harm to competition. 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] The AUCL should be implemented in a manner consistent with these objectives of competition policy.

Tethering unfairness as it relates to conduct covered by antitrust laws to the traditional antitrust concept of harm to competition ensures that the AUCL will be enforced in a manner consistent with the economic principles underlying the antitrust laws, which are designed to promote competition and enhance consumer welfare. There is a significant risk that application of the AUCL prohibition of "unfair competition," untethered from the principle of harm to the competitive process, can lead to regulatory outcomes that weaken competition between rivals and deprive consumers of the benefits that vigorous competition provides.[3] Indeed, experience has taught us that robust and undistorted competition produces substantial benefits for consumers

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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.

[3] Under U.S. law, the term "unfair competition" typically refers to deceptive practices that do not come within traditional antitrust concerns; the term "unfair methods of competition" is used in the U.S. Federal Trade Commission Act to refer to conduct that does come within traditional antitrust concerns.

and society as a whole by promoting growth, spurring innovation, and facilitating the efficient allocation of resources.

We also respectfully urge the deletion of Article 6, which prohibits an undertaking from "taking advantage of its comparative advantage position."[4] China has recognized that the objective of competition law is the protection of competition and consumer welfare, not individual competitors. It follows from this understanding that competition law should not be concerned with particular outcomes of contractual negotiations between parties. The conditions under which bargaining between parties is likely to result in harm to competition rather than the mere redistribution of rents between parties are limited. As the U.S. antitrust agencies explained in recognition of this point, "[i]n the absence of harm to competition, governments generally should make every effort not to interfere in privately-negotiated contracts."[5]

Moreover, regulating relative bargaining power may cause harm to consumers rather than offering them additional protection. The fundamental economic role of contracting is for parties to efficiency allocate costs, risks, and rights among themselves. In the absence of a demonstrable market failure, the outcome of a competitive contracting process is likely to best serve the interests of consumers. The risk of ex post regulation interfering with the outcome of a contract negotiation on the ground that one party has superior bargaining power increases significantly the costs of contracting for firms—costs that are inevitably passed on to consumers in the form of higher prices or fewer goods and services.[6] Businesses will adjust other terms of the contract that each had considered efficient ex ante. Adjusting terms that would have otherwise been considered efficient may then result in an increase in contracting costs. Accordingly, both parties will be worse off and will generally pass on the increased costs to consumers through an increased quality-adjusted price.

I. Unfairness Under the AUCL Should Be Linked to Universal Competition Law Principles

The regulation of unfair methods of competition is a common feature of the regulatory landscape in many jurisdictions. For competition policy regimes that have adopted a welfare and effects-based approach to antitrust law, but also enforce a prohibition against unfair methods of competition, the dual enforcement mandate can potentially create a significant tension if not outright conflict between the two regimes. Economically sound competition policy is grounded firmly in the notion that its application does not regulate ex post outcomes between firms—that is, competition policy should not pick winners and losers in the marketplace—but rather, should govern the competitive process. However, laws prohibiting unfair methods of competition can be interpreted as barring some vigorous competitive conduct that makes consumers better off but has a burdensome effect on a rival.

[4] "Comparative advantage" has a specific meaning in economics; it is the basis for mutually advantageous exchange. Therefore, we interpret "taking advantage of its comparative advantage position" to refer to bargaining power as opposed to "comparative advantage" in the economic sense.

[5] International Competition Network, *Report on Abuse of Superior Bargaining Position* at 17 (April 2008), http://www.internationalcompetitionnetwork.org/uploads/library/doc386.pdf [hereinafter ICN Report].

[6] Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. ASS'N 356, 360-61 (May 1980).

Modern competition regimes committed to an economic approach to antitrust that are also charged with enforcing a law against unfair methods of competition are thus faced with a difficult question: How can they interpret the prohibition of unfair methods of competition and remain faithful to the economic approach underlying enforcement of their antitrust regime? From an economic perspective, there is no generally accepted definition of "unfairness." However, one can derive two general and competing views of the proper relationship between unfairness and competition law.

The first contemplates unfairness liability as a complement to antitrust enforcement. Unfairness liability under this view is designed to reach business conduct that generates the same types of effects—the anticompetitive acquisition or creation of market power—as business conduct that would otherwise violate the antitrust laws. Unfairness liability under this view might usefully protect consumers by filling gaps in the competition law, but would not undermine the objectives of competition law.

The second view contemplates competition law and unfairness as substitutes. Under this second view, unfairness liability is entirely untethered from competition policy principles. This view of unfairness liability condemns aggressive practices that are procompetitive, and thus undermines the objectives of an effects-based competition law regime. The 100-year history of the U.S. Federal Trade Commission (FTC) and its application of the ban on unfair methods of competition pursuant to Section 5 of the FTC Act is indicative of the notion that unfairness untethered from competition law principles is likely to lead to bad outcomes for consumers.[7]

Economic theory can illuminate the tradeoffs facing competition regimes choosing between these two competing views. The first view interprets "unfairness" from an ex ante perspective—that is, the relevant question is whether firms have been afforded an opportunity to compete. The second view interprets unfairness from an ex post perspective—that is, the relevant question is whether the outcome of the competitive process disadvantages one or more firms.

Evaluating unfairness from an ex ante perspective can be consistent with an economic approach to antitrust. Indeed, it can overlap entirely from an economic perspective because the relevant inquiry is focused on whether there was an opportunity to compete. The competitive process is evaluated rather than outcomes for individual competitors. Ex ante fairness can be determined by considering such things as whether there are barriers to entry in the relevant market, or whether rivals were anticompetitively excluded from the *opportunity to compete* for distribution. This approach to unfairness is consistent with the effects-based approach of traditional competition laws. While this interpretation of unfairness overlaps considerably with

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[7] *See generally* William E. Kovacic & Marc Winerman, *Competition Policy and the Application of Section 5 of the Federal Trade Commission Act*, 76 Antitrust L.J. 929, 940 (2010) ("The FTC's record of appellate litigation involving applications of Section 5 that go beyond prevailing interpretations of the other antitrust laws is uninspiring."); Joshua D. Wright, Comm'r, Fed. Trade Comm'n, What's Your Agenda?, Remarks at the ABA Antitrust Spring Meeting 7 (Apr. 11, 2013), http://www.ftc.gov/sites/default/files/documents/public_statements/whats-your-agenda/130411abaspringmtg.pdf ("[I]t is no surprise that [Kovacic & Winerman] conclude the 'FTC experience with Section 5 is generally a bleak record.'").

the competition laws in any country—it does not eliminate the role of unfairness analysis to reach conduct that anticompetitively creates market power but is not otherwise reached by antitrust laws.

Alternatively, fairness can be evaluated only by examining the result of competition in the market and observing whether outcomes were fair from an ex post perspective. Economists have long understood that market outcomes that appear to be "unfair" or one-sided are often efficient. Evaluating unfairness ex post undoubtedly will create tension with an antitrust law the goal of which is to maximize consumer welfare and promote competition generally. Ex post unfairness allows competition tools to govern outcomes of bargaining disputes, prices themselves, or other conduct unlikely to harm competition. For example, leveraging bargaining power and engaging in price discrimination both have the potential to increase consumer welfare but would often seem to violate an ex post fairness standard. Further, regulating conduct that is unlikely to harm competition can chill procompetitive conduct, such as innovation, that benefits consumers.

Again, the United States experience is a useful example to illustrate the pitfalls of an ex post approach to unfairness. For nearly 100 years, the FTC operated without a consistent definition of an "unfair methods of competition" and liability was often based upon ex post unfairness. During that time, the FTC's application of its unfair methods of competition authority is now understood to have punished much procompetitive conduct and been applied in a manner inconsistent with the goals of the antitrust laws.[8] In 2015, more than a century into its existence, the FTC corrected this approach by linking unfairness explicitly to the concept of harm to competition as understood under the traditional U.S. antitrust laws. The 2015 FTC Unfair Methods of Competition Statement embraced only ex ante unfairness and tethered that notion to the economic principles underlying sound antitrust policy.[9] The policy statement made clear that the FTC will be guided by three principles when enforcing Section 5's "unfair method of competition" provision: (1) promote consumer welfare as that term is generally understood in U.S. antitrust law precedent; (2) evaluate conduct by balancing harm to competition or the competitive process against the procompetitive benefits of that conduct; and (3) do not apply Section 5 to the conduct if the U.S. antitrust laws (the Sherman or Clayton Act) are sufficient to address the competitive concern at issue.

Tying unfairness to antitrust principles ensures the alignment of unfairness with the economic principles underlying competition laws. Enforcement of unfair methods of competition statutes should focus on harm to competition, while taking into account possible efficiencies and business justifications. For example, invitations to form a cartel fall outside the scope of the U.S. antitrust laws but are condemned as an unfair method of competition because of the threat they pose to consumer welfare. While unfairness can be a useful tool in reaching conduct that harms competition but is not within the scope of the antitrust laws, it is imperative that unfairness be linked to the fundamental goals of the antitrust laws.

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[8] *See* Kovacic & Winerman, *supra* note 7, at 940-43; Wright, *supra* note 7, at 6-7.

[9] Fed. Trade Comm'n, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (Aug. 13, 2015), https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf.

II. Regulating Relative Bargaining Power Is Likely to Harm Consumer Welfare

We respectfully urge that Article 6, which regulates relative bargaining power, be omitted in its entirety from the AUCL. Regulating relative bargaining power may harm consumers. As the U.S. antitrust agencies have explained:

> With regard to contracts between parties at different levels of the manufacturing-distribution chain (that is, between non-competitors), it is highly unlikely that particular provisions of such contracts will have anticompetitive effects. To the contrary, contracts between parties at different levels of the manufacturing-distribution chain are likely to reflect an efficient allocation of risks and duties among the parties. . . . The package of terms that make up a contract between parties in a vertical relationship reflects the parties' agreement as to how to allocate rights and risks between them in an efficient manner. If a particular provision is deemed by the government to be an "abuse of a superior bargaining position" and therefore not available for use in a contract, the parties likely would adjust other terms of the contract, such as by adjusting the contract price. The result may be a less efficient contract with higher contracting costs and both parties potentially worse off. Ultimately, the quality-adjusted price to the ultimate consumer would tend to increase, a result antithetical to the goals of U.S. competition policy.[10]

In addition, allowing a monopolist to exercise lawfully obtained market power has several procompetitive benefits. First, the ability to recover quasi rents[11] provides an increased incentive for firms to innovate.[12] Second, allowing lawful monopolists to make strategic decisions about pricing (e.g., price discrimination) will often lead to efficient pricing in the market. Third, the ability of a lawful monopolist to exercise market power will attract entry and innovation.[13]

Lastly, there is no real limiting principle to ex post condemnation of disparities in bargaining power, and therefore it is likely firms will be penalized even though it is not plausible that they have is market power. This creates a situation in which the agency is enforcing garden variety pricing decisions.

III. Conclusion

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[10] ICN Report, *supra* note 5, at 17.

[11] A quasi-rent is an economic rent (the reward paid to a factor that exceeds its opportunity cost) that provides the incentive for the up front investment required to generate the rent, such as the portion of the return to a patent that is required to induce investment in innovation.

[12] *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 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.").

[13] *See, e.g.*, *id.*

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