DEPARTMENT OF JUSTICE

SOME COMMENTS ON THE

ABUSE-OF-DOMINANCE PROVISIONS

OF CHINA'S DRAFT ANTIMONOPOLY LAW

Remarks by

Gerald F. Masoudi
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Presented to the

UIBE Competition Law Center Conference on
Abuse of Dominance: Theory and Practice

Beijing, China

July 21, 2007

SOME COMMENTS ON THE ABUSE-OF-DOMINANCE PROVISIONS OF CHINA'S DRAFT ANTIMONOPOLY LAW

Gerald Masoudi
Deputy Assistant Attorney General,
Antitrust Division, U.S. Department of Justice

UIBE Competition Law Center Conference:
Abuse of Dominance: Theory and Practice
Beijing, China
July 21, 2007

It is a pleasure to be here today and to express my views on the abuse-of-dominance provisions of the new draft of the Antimonopoly Law. I would like to thank the Competition Law Center and the Bureau of Fair Trade at SAIC for inviting me to speak here today.

I am privileged to say that this is my fifth trip to China to discuss the Antimonopoly Law. I have been very impressed by the coordination within the Chinese government on this matter, and with the openness that has been shown to the ideas and experiences of antitrust enforcers from around the world. I am also pleased that I have been able to learn more on each trip to China about the impressive history, geography, and people of China.

The abuse-of-dominance provisions are a very important part of the draft Antimonopoly Law. The treatment of unilateral conduct by firms with dominant market positions is the most challenging and difficult area of antitrust policy because it is often very difficult to distinguish between beneficial, aggressive competition and harmful, exclusionary conduct.

My comments on this topic are based on an informal English translation of a draft circulating within the U.S. legal community that purports to reflect the changes to the draft AML that were made after the second reading. I therefore may not have a fully accurate understanding of the provisions as they now stand, and I apologize in advance for any errors in interpretation that I may make as a result.

I. **Determining Whether a Firm has a Dominant Market Position**

Let me begin with the threshold issue of determining whether a firm is dominant. The last paragraph of Article 16 sets out the definition of a "dominant market position." This definition looks to the ability of a firm to control the price or quantity of products in the marketplace, to control other transaction conditions in the market, or to block or "affect" entry by other firms into the market. Article 17 provides a non-exclusive list of factors that will be considered in determining whether a firm has a dominant market position, and Article 18 sets out market share levels that can be used to presume a dominant market position.

A. Definition of "Dominant Market Position"

The focus in Article 16 on the ability of a firm to control price or exclude competition is consistent with the traditional definition of monopoly power used in the United States. More recently, however, we are defining monopoly power in more precise economic terms, by looking to whether the firm has the ability to raise prices substantially above competitive levels for a sustained period of time. If a firm's power to control prices is only temporary -- until, for example, other firms complete their entry into the market -- we would not find a dominant market position, since the market itself

would correct any competitive problems without the need for intervention by the antitrust authorities. I therefore believe that the definition in Article 16 would be improved by adding that the power to control prices or restrict entry must be persistent over time.

B. Market Share Presumptions

Article 18 provides that if a firm has a market share of 50 percent or more, it may be presumed to have a dominant market position. The experience in the United States indicates that a market share of 50 percent is too low to provide a firm with monopoly power. We generally would not begin examining whether a firm has a dominant market position unless it has at least a 60 or 70 percent market share. Even when a firm has such a share, we examine the actual market situation -- including barriers to effective new entry, the likelihood of leapfrog competition, and the durability of the high market share -- to determine whether the firm actually has the power to raise price significantly over competitive levels. I would therefore suggest that the draft Antimonopoly Law could be improved by increasing to 60 –70 percent the market share at which a single firm is presumed to have a dominant market position. I am pleased, however, to have heard here today from Chinese government officials that whatever the precise percentage market share set forth in the presumption, the respondent firm has the right under the draft law to rebut any presumption based on the factors set forth in Article 17.

I would go a step further and recommend that Chapter III of the Antimonopoly Law be revised to provide that a firm with *less* than a 50 percent market share benefit from a presumption that it does *not* have a dominant market position. This would be supported by economic thinking about monopoly power and our actual experience in the United States, which suggests that monopoly power does not exist unless market shares

are substantially higher than 50%. More importantly, it would reassure many firms that they can compete vigorously in the marketplace without running afoul of the Antimonopoly Law.

C. Joint Dominance

Article 18 also provides for a presumption of "joint dominance" where two firms have a combined market share of more than 2/3 of the market, or where three firms have a combined market share of more than 75 percent, except for firms with a market share of less than 10 percent, who would not be subject to the presumption. In my view, this provision as currently drafted is unclear and confusing, and is likely to harm, rather than promote, competition in Chinese markets.

Before I discuss our more fundamental concerns with the concept of joint or collective dominance, let me first address the question of clarity. Under the presumptions relating to joint dominance, if one firm has more than 50 percent of the market, then will the second and third presumptions still apply? For example, if one firm has a 55 percent market share and the number 2 firm has a 12 percent market share, will both be presumed to have a dominant market position, or does the two-thirds joint dominance presumption only apply when the single firm presumption is not met? Or suppose the top firm has a 45 percent market share, the second firm has a 25 percent share, and the third has a 12 percent share. Will the third-ranked firm be presumed to be dominant in that situation? Or what about the situation where there are three equal-sized companies in the market, each with about 33 percent of the market? Does it make sense to presume that all of them are dominant, when in fact all of them are competing vigorously against each other and none of them alone has the power to control prices or exclude competition? In the event

that the concept of joint dominance is retained in the draft law, I would recommend that Article 18 be revised to clearly answer these questions.

Now to my more fundamental concerns. Competition law generally should not target the unilateral practices of firms in the market unless those practices are likely to restrain competition and thereby create, strengthen or maintain a dominant market position. The draft Antimonopoly Law appears to have accepted that principle, since only dominant firms are prohibited from engaging in the practices listed in Article 16 when they constitute abuses. Non-dominant firms are free to engage in any practices that will strengthen their competitive position. By raising the possibility that the number 2 and number 3 firms in a market might be viewed as being in a dominant market position, however, the Antimonopoly Law would be sending the message that China does not want these firms to use the full range of competitive tools available to compete aggressively against the market leader. Treating these firms as dominant (and thereby making them more cautious about competing) is likely to hurt competition, since it is often the case that the number 2 and number 3 firms will be in the best position to compete most effectively against the top firm in the market.

There is one scenario where joint dominance does raise significant competitive problems: where firms get together and agree to act in concert as a joint monopoly. The EC generally requires some concerted action among the competitors before it will apply its joint dominance provisions. From the United States' perspective, we would simply see an agreement among competitors as a cartel -- an unlawful agreement among competitors to restrain competition. As such, it is most easily addressed by applying the prohibitions in Article 13 of the draft law relating to monopoly agreements. I believe that

China's efforts to promote competition in its markets will be strengthened by eliminating the presumptions of dominant market position for multiple firms, and rely instead on the prohibitions against agreements among competitors to restrain competition.

II. **What Conduct Should Constitute an Abuse of a Dominant Market Position**

I would now like to turn to the list of possible abuses of a dominant market position contained in Article 16 of the draft Antimonopoly Law. Before I provide comments on the specific activities covered by Article 16, however, it is important to remember what harms competition law seeks to prevent by prohibiting abuses of a dominant market position.

The basic objective of competition laws should be to ensure that the competitive process functions properly, so that market forces will operate to drive firms to compete for customers through low prices and attractive product choices. Competition laws should not be used to insulate or protect individual firms from the rigors of the competitive process, or to protect small businesses from the challenges of having to compete against more efficient larger firms. Nor should competition laws stand in the way of firms obtaining large market shares – or even monopoly positions – through innovative products, business skills or good, hard competition. Competition laws should not prevent firms from reaping the rewards that come from success in the marketplace.

Antitrust enforcers should focus on whether specific conduct, in a particular market situation, undermines the competitive process by allowing a dominant firm to strengthen or preserve its market dominant position. With that framework in mind, I would now like to provide some comments on the list of abusive conduct in Article 16.

A. Below-Cost Pricing

The draft Antimonopoly Law provides that selling below cost without any justification can be an abuse of a dominant market position. But a primary goal of the Antimonopoly Law should be to encourage low prices. Low prices -- even prices below cost -- should be lawful unless they can be shown to harm the competitive process. Theoretically, a firm with a dominant market position could engage in below-cost pricing that would be anticompetitive and that would warrant antitrust enforcement action. This could occur where a dominant firm prices its products below cost for a sufficient time to drive out competitors, and then, once it has succeeded in creating or strengthening its monopoly power, recovers the lost revenues by raising prices to monopoly levels. We call this "predatory pricing." But our practical experience is that it almost never makes economic sense for a firm with a large market share to use this technique to obtain monopoly power, since it must lose money on a large volume of sales in order to drive competitors out of the market, and the firm may never recover these lost revenues. On the contrary, we have found that sales that appear to be below some measure of cost typically have a non-predatory justification -- for example, to clear out old inventory, to entice consumers to try products, or to meet competition from other competitors. Only when the prices are below marginal or average avoidable costs do we become suspicious that the pricing is not economically rational and therefore an indicator of potential anticompetitive behavior.

China should be very careful not to include provisions in the Antimonopoly Law that will cause firms to set prices higher than they otherwise would in order to avoid over-stepping the prohibitions in Article 16. Therefore, I would recommend that the Antimonopoly Law or its implementing regulations make clear that this provision will

apply only when prices are below marginal or average avoidable costs and there is a likelihood that the firm engaging in this practice will be able to recover its lost profits later by raising its prices after it has driven competitors out.

B. Unfair High Prices

The first subparagraph of Article 16 provides that charging "unfair" high prices may be an abusive practice. I do not believe that high pricing is an appropriate subject for antitrust enforcement. High pricing, standing alone, does not harm the competitive process; if anything, it serves as a signal and inducement to other firms to enter the market. It is true that high pricing may be an indicator that a firm has monopoly power, but Chinese government officials have made it clear that the Antimonopoly Law does not make having a monopoly unlawful. If it is legal, as it should be, to obtain a monopoly position through technological innovation or superior business skills, then it should be unlawful for such a firm to charge a market-determined monopoly price for its products. Indeed, we should be pleased when firms that legitimately obtain monopoly positions are able to obtain monopoly profits, since it is the prospect of obtaining higher-than-normal profits that drives firms to become more efficient and to develop innovative products. Second-guessing the unilateral, non-exclusionary pricing decisions of dominant firms will lead to price regulation by the government, which is not consistent with the market-oriented goals of competition laws.

C. Refusals to Deal

Subparagraph (3) of Article 16 provides that a refusal to deal with another party may be an abuse of a dominant market position, unless it is justified. There may be very

unusual situations where a dominant firm's refusal to sell its products to another firm could harm competition by excluding an existing rival from the market or foreclosing entry by a potential competitor. Generally, however, dominant firms should be allowed to decide with whom they will do business, just as is the case with smaller firms. At the very least, a violation of the Antimonopoly Law should not be found unless a refusal to deal has no justification and makes no economic sense except as a means to exclude competition in order to create, strengthen or maintain a monopoly position.

This principle is particularly important in the context of decisions by an intellectual-property-right holder as to whether, and to whom, to license its IP right. Article 54 exempts the exercise of intellectual property rights from the Antimonopoly Law, but provides that abuses of intellectual property rights are subject to the AML, including the abuse of dominant market position prohibitions.

Article 54 appears to recognize that the simple exercise of IP rights, without more, will not be a violation of the Antimonopoly Law. Since the right to exclude others from using the invention is the essence of an intellectual property right, the unilateral decision of the right holder to exclude some or all applicants from using its protected intellectual property is the most simple exercise of IP rights and should not be subject to antimonopoly attack as an abuse. This is so regardless of whether the IP right at issue conveys monopoly power or puts the right holder in a market dominant position.

An IP owner's right to refuse to grant a license to another firm is a core part of the exclusive nature of the IP right and is directly tied to creating incentives for innovation. Requiring an IP owner to license its IP right, based on its simple refusal to license without some accompanying restriction that harms competition, would diminish the

incentive for the IP owner and others to invest in research and development efforts that lead to the creation of IP rights. A diminution in such investment would, in turn, slow innovation, harming consumers and reducing productivity gains for the economy as a whole.

D. Other Abuses

Article 16 includes several other examples of abusive conduct, including exclusive dealing, tie-in sales and price discrimination, as well as a catchall provision for other activities that the Antimonopoly Authority determines to be abusive. I believe that the provision on tie-in sales was improved after the second reading by adding that such conduct would be abusive only if it was without justification. Since all of these activities can have efficiency justifications in some circumstances, and in other circumstances could have anticompetitive effects, it is important that the Antimonopoly Authority carefully evaluate both the procompetitive and anticompetitive effects of these activities in the context of the specific relevant market affected before concluding that they constitute an unlawful abuse of a dominant market position.

III. **Concluding Remarks**

Finally, I would like to close by commending the Standing Committee for eliminating the minimum fine in Article 46 for abuses of a dominant market position. This is an important improvement in the Antimonopoly Law that will help ensure that the law does not deter procompetitive behavior by firms that fear they may be subject to Chapter III. Thank you. I look forward to discussing these matters further with you.