DEPARTMENT OF JUSTICE

KEY ISSUES REGARDING

CHINA'S ANTIMONOPOLY LEGISLATION

Remarks by

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Presented to the
International Seminar on
Review of Antimonopoly Law
Hangzhou, China

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I am delighted to have the opportunity to visit China again and to provide the perspective of the U.S. Department of Justice on China's efforts to adopt an antimonopoly law. We very much appreciate the willingness of our Chinese colleagues to discuss with us complex issues that have arisen in the drafting process and to hear about the lessons that we have learned from our long experience with antitrust enforcement. I had the pleasure of meeting some of you when I visited Beijing in March and look forward to continuing our discussions at this seminar.

As some of you know, I am Deputy Assistant Attorney General in charge of international, appellate and legal policy matters in the Antitrust Division of the United States Department of Justice. The Antitrust Division is led by Assistant Attorney General Thomas Barnett, whom some of you may have met when he visited Beijing in June of last year. The Antitrust Division is responsible for enforcing the Sherman Act and the Clayton Act. We have exclusive authority to bring criminal prosecutions for violations of the antitrust and related laws, and last fiscal year we prosecuted 22 companies and 30 individuals for criminal violations of those laws. We also share with our sister agency – the Federal Trade Commission – responsibility for enforcing the antitrust laws against anticompetitive mergers, non-criminal anticompetitive agreements and monopolization conduct.

Today, I would like to focus my remarks on three topics: premerger notification requirements, analyzing abuses of a dominant market position, and the relationship between intellectual property rights and the antimonopoly law.

I. Merger Issues

A. Appropriate Nexus

At present, more that 70 jurisdictions around the world have some form of antitrust merger review, and when China's Antimonopoly Law is enacted, we will add one more jurisdiction to that list. Globalization has also resulted in many more transnational merger and acquisition transactions. The result of these two developments is that more and more transactions are now facing review by multiple antitrust authorities. Needless review by multiple antitrust enforcement authorities can impose significant burdens and costly delays on corporate transactions, as well as heavy and non-productive burdens on the resources of the reviewing agencies themselves. This recognition led the International Competition Network (ICN), a network of nearly 90 antitrust agencies devoted to promoting greater convergence on sound competition principles, to focus much of its initial efforts on merger review issues.

The result of ICN's work in this area was a set of recommended practices that reflects international consensus on basic principles for premerger notification systems. One of the most fundamental principles is that each antitrust regime should seek to screen out transactions that are unlikely to result in appreciable competitive effects in its territory so that transactions subject to its pre-merger notification requirements have an appropriate "nexus" with its territory. ICN recommends that this can best be done by requiring that at least two parties to a transaction, or at least the acquired party, have material sales or assets within the

territory. Furthermore, ICN recommends that the evaluation of sales or assets be limited to those of the entities or businesses that will be combined in the transaction.

We understand that China has considered requiring notification of mergers where the combined sales or assets in China of all the parties to the transaction exceed a certain threshold. This approach is specifically discouraged in the ICN recommended practices, which say:

> Notification should not be required solely on the basis of the *acquiring* firm's local activities, for example, by reference to a combined local sales or assets test which may be satisfied by the acquiring person alone, irrespective of any local activity by the business to be acquired. [Comment 3 to Recommended Practice C][emphasis added].

In other words, if, for example, China were to require notification of foreign transactions where the combined sales or assets in China of the parties to the transaction exceeded 5 billion yuan, that test in some circumstances could be satisfied by reference to the sales or assets of just one firm, the acquiring firm. In that situation, such a notification threshold would oblige that acquiring firm to notify all of its transactions anywhere in the world, regardless of whether the acquired party in each transaction has any connection to China. For example, if Boeing were to establish a large facility in China, then Boeing's acquisition of even a very small company in the United States with no connection to China – such as a small trucking firm that does business only in the United States – would be needlessly subject to notification in China.

In the United States, we ensure that transactions have an adequate nexus with the United States by exempting certain foreign acquisitions from notification obligations. We have two basic exemptions for foreign transactions: one for the acquisition of foreign assets and one for the acquisition of foreign stock. We exempt acquisitions of foreign assets where those assets generate less than about $57 million in annual sales in the United States. We

exempt the acquisition of stock in a foreign company where the acquired company has less than about $57 million in assets in the United States, or less than $57 million of annual sales in or into the United States. Moreover, where the acquisition of stock in a foreign company is made by another foreign company, and that acquisition does not give the acquiring company a controlling interest in the other company – by which we mean that it will hold less than 50% of the acquired company's voting stock – the transaction is exempt from notification obligations. I would note that we also exempt transactions if both parties are foreign, the value of the transaction is less than about $227 million and the combined sales of the parties in the United States, and their combined assets in the United States, are both less than about $125 million.[1]

B. Transactions Exempted from Notification Requirements

I understand that our Chinese colleagues may have an interest in understanding what exemptions to premerger notification requirements may be appropriate. In the United States, we have a number of exemptions, some set out in statute, and others set out in implementing regulations. These exempted transactions generally fall within one of two categories: either the transactions are of a type not likely to raise substantive antitrust problems or the transactions are subject to premerger competitive review by another regulatory agency. (In the latter case, the regulatory agency will normally notify us of the transaction.) In addition to the exemptions for foreign transactions I just described, some other examples of transactions exempted from notification requirements include: (i) the acquisition of assets in the ordinary course of business (such as the purchase of airplanes by an airline); (ii) the acquisition of residential or commercial buildings, hotels, and unproductive recreational or agricultural land;

[1] All of these premerger notification thresholds are adjusted annually based on changes in the Gross National Product of the United States.

(iii) acquisitions where the acquiring person and the acquired person are considered to be part of the same entity[2]; and (iv) the acquisition of less than 10% of a company's voting securities, if the acquisition is solely for investment purposes. We also exempt bank mergers from our notification requirements because they are subject to premerger competitive review by bank regulatory agencies, which are required to obtain the views of the Antitrust Division on the competitive effects of the transaction. I would point out that under the U.S. system, even if a transaction is exempted from premerger notification requirements, in almost all cases the antitrust agencies are still empowered to investigate the transaction and take enforcement action if it is likely to result in a substantial lessening of competition in a relevant market in the United States. [3]

II. Dominant Market Position and Abuse of Dominance

Let me now turn to the second topic of my remarks -- how best to approach issues concerning the abuse of a monopoly or dominant market position. This is one of the most difficult and challenging areas of antitrust enforcement policy. We all can recognize the competitive harm that comes from competitors conspiring to fix prices or allocate markets. But when one firm, acting unilaterally, decides to compete aggressively, with the result that its competitors lose or have lower profits, it is very difficult to distinguish between conduct that is harmful to competition and conduct that is actually pro-competitive. If we, as antitrust

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[2] Examples would include the acquisition of voting securities of a company where 50% or more of its voting securities are already held by the acquiring person, or transactions in which assets are transferred from one controlled corporate subsidiary to another controlled subsidiary.

[3] A complete list of exempted transaction can be found in 15 U.S.C. §18a(c) and 16 CFR Part 802.

enforcers, intervene to stop or punish behavior that is actually efficient and procompetitive, then we have done a disservice to our citizens and to the business community by harming the competitive process.

An antitrust agency must be cautious about complaints it receives from competitors. Such complainants often try to avoid legitimate competition by seeking protection from the government from competitive pressures. Our job, however, is to protect not individual enterprises but rather the proper workings of the market, and the operation of the market means that some firms will succeed and others will fail.

For these reasons we have learned the importance of proceeding carefully before concluding that the unilateral conduct of a firm – even a firm with monopoly power – is in fact anticompetitive and warrants enforcement action. This does not mean that we never challenge conduct under our monopolization statute – Section 2 of the Sherman Act. Indeed, we have brought several cases against firms with monopoly power for engaging in conduct that made no economic sense other than to exclude competition and to maintain their monopoly position. We will not bring an enforcement action against the unilateral conduct of a firm with monopoly power, however, unless rigorous economic analysis demonstrates two things: ***first,*** that the firm does indeed have, or threatens to obtain, monopoly power; and ***second***, that the conduct is certain to be anticompetitive in light of the particular circumstances of the relevant market.

A. Determination of Dominant Market Position

Under U.S. antitrust law, a firm has traditionally been considered to have monopoly power when it has the ability to control prices or exclude competition over an extended period

of time. We hope that China's Antimonopoly Law will define dominant market position in the same way.

In determining whether a firm has monopoly power, we first must determine the relevant product and geographic markets in much the same manner as we would in evaluating a transaction under our merger guidelines. There are almost always several possible market definitions, and the correct market is frequently not obvious at the beginning of an investigation. Once we are confident that we have identified the appropriate product and geographic markets, and have determined the market share of the firm under investigation, we will then carefully evaluate the structure and dynamics of the market, entry barriers, technological innovation and other factors – many of which are listed in the draft Antimonopoly Law – to determine whether the firm in fact has the power to raise prices and exclude competition over a sustained period of time. We do not believe that any presumptions of monopoly power based solely on the market share of the firm are appropriate, or even helpful to the business community, since the analysis depends so much on the unique factors present in the particular market we are evaluating. Market share presumptions for findings of joint dominance are even less useful, since it makes no sense to aggregate the market shares of competitors to find collective dominance unless there is some agreement among those firms to exercise their power jointly, at which point the agreement can be addressed much more easily under provisions prohibiting agreements among competitors that restrain competition. Therefore, we recommend that China not presume the existence of a market dominant position based on market share alone. Alternatively, if the Chinese Government believes that some presumption is necessary, then we would recommend

that it be a rebuttable presumption, allowing the firm under investigation to show that it does not have the durable power to raise price or exclude competition.

Although we believe it is not warranted to create a presumption that there ***will*** be a finding of dominance above some minimum threshold of market share, it is important to define the market share below which there ***will not*** be a finding of dominance. In the United States, we do not pursue allegations of unlawful monopolization if the market share of the subject company is less than 50%, since we have not found a company to have the durable power to control prices and exclude competition with such a small market share. Therefore, we believe it would be both appropriate and helpful for China to provide in its antimonopoly law or subsequent implementing rules or guidelines that market shares below a certain level -- such as 50% -- will not be deemed to constitute a dominant market position.

B. Determining Whether Conduct Constitutes an Unlawful Abuse

With respect to determining whether particular conduct by a firm with monopoly power should be challenged under the antitrust laws, I would first note that each of the examples of abusive conduct listed in the draft Law are the kinds of conduct that competitive firms ordinarily engage in. They can also, in limited circumstances, be used in an anticompetitive manner.

For example, selling at low prices is normally what we want companies – even monopolists – to do. There are many legitimate reasons why firms might sell below their cost, such as to clear warehouse space for new models, to sell products before they become spoiled or obsolete, or to get consumers to try new products. In rare instances, a dominant firm might try to price its products at unsustainably low levels, not for any legitimate business reason, but only to drive its competitors out of the market so that can raise prices to monopoly

levels later. This strategy of what we call "predatory pricing," however, is so inherently risky – since it involves sacrificing real current profits for the very speculative possibility of recouping even more profits in the future – that we have rarely seen it in the actual marketplace. If, in order to prevent such rare cases, antitrust enforcement policy were to deter dominant firms from discounting their products, such enforcement policy would cause much more harm to the market than any possible benefit. Since aggressive price cutting is so central to a properly functioning market, antitrust enforcement against aggressive price cutting has a high danger of chilling the competitive process. Therefore, we recommend that the Antimonopoly Law be both drafted and implemented in a way that does not discourage legitimate aggressive discounting, even by firms with dominant positions. This could be done by including in the Law or in implementing regulations requirements (i) that the prices at issue be below an appropriate measure of cost and (ii) that the dominant firm is likely to be able to recoup its losses in the future.

This same reasoning applies to all the other examples of abusive conduct listed in the draft Antimonopoly Law. Refusals to deal, exclusive dealing, tying, and price discrimination all can be used for procompetitive, efficiency-enhancing reasons and in only very limited circumstances will have anticompetitive effects, even when used by a firm with a dominant market position. Indeed, practices such as these are very common in highly competitive markets, reflecting that such distribution methods can reduce costs and improve efficiency. Therefore, it is important that these practices not be presumed to be anticompetitive, either in the law or by the antimonopoly enforcement agency in implementing the law. These practices should be viewed as unlawful only if, after a detailed analysis of the conduct, the market, and proffered business justifications, it is determined that the conduct harms competition by

creating, maintaining or strengthening the monopoly power of the dominant firm and that the conduct makes economic sense to the firm only because of its anticompetitive effects.

III. Relationship between the Antimonopoly Law and Intellectual Property Rights

Finally, I'd like to talk about the relationship between the Antimonopoly Law and intellectual property rights. The one article in the draft Antimonopoly Law addressing this issue has received more attention from the foreign business community than any other provision. These concerns have been heightened by speeches by various Chinese officials and press reports complaining of licensing practices of some foreign technology companies that some Chinese companies believe are unfair and calling for compulsory licensing of foreign technology. Some of the reported statements expressly referenced the need to use the Antimonopoly Law to accomplish that goal.

There is now international consensus that innovators must be provided the right to exclude others from appropriating their inventions if they are to have sufficient incentive to engage in research and development activities despite the substantial costs and risks inherent in such activities. It is also well recognized that technological innovation is one of the most important factors in fostering a dynamic and competitive market. Innovation drives down costs, brings new products to market and allows new entrants to overcome the advantages and entry barriers enjoyed by incumbent dominant firms.

There is, therefore, no conflict between the exclusive rights offered by the intellectual property laws and the promotion of consumer welfare by the antitrust laws. We, as antitrust enforcers, must allow intellectual property right holders to enjoy the benefits of their IP rights. In other words, they should be free to exercise their right to exclude others from using an

invention protected by patent or copyright, or to license some applicants but not others, without fear of challenge under the Antimonopoly Law. Similarly, IP right holders should be able to take advantage of the incentives provided by the IP laws by being free to charge as high a royalty as the market will bear without having to worry that it might be construed as an abuse of their IP rights or of their market position.

That being said, it is also true that the exercise of intellectual property rights may be combined with other action not necessarily contemplated by the intellectual property laws in such a way as to raise legitimate antitrust concerns. Those situations must be carefully analyzed on a case-by-case basis, just like any other anticompetitive agreement or abuse of dominance allegation, to determine whether competition has been unreasonably restrained. Where restrictions in licensing agreements are at issue, it is important to recognize that most IP licensing practices are procompetitive, and those practices are often aimed at facilitating the dissemination of technologies into the marketplace, reducing transaction costs and preventing free-riding. It is also important to remember that intellectual property right holders should not be presumed to have a market dominant position just because they hold a patent or copyright. In many cases, there are other products or technologies that compete with the patented or copyrighted item and that prevent the exercise of any monopoly power.

The extent to which investment in research and development takes place is dependent on the confidence that innovators have that, if their efforts prove successful, they will be able to take advantage of the benefits of their intellectual property rights in the future. Thus statements calling into question whether those intellectual property rights will be protected in China can have a significant negative impact on innovation for years to come. I hope that our colleagues in China will make efforts to provide assurances to the domestic and foreign

business communities that the Antimonopoly Law will be implemented in a way that respects and supports the full and legitimate exercise of intellectual property rights.

IV. Conclusion

Let me conclude by thanking the Ministry of Commerce, Asian Development Bank and OECD for inviting me to participate in this seminar. Enactment of the Antimonopoly Act will constitute an important milestone for China, but it will be only the first step in establishing an effective competition policy that truly benefits the Chinese market. Developing a sound enforcement policy and training the staff of the Antimonopoly Authority to implement the Law in a coherent and effective manner will present significant challenges. Our agencies stand ready to assist you in that journey and to help China realize its goal of having a world-class antimonopoly regime. Thank you for considering our views and I look forward to a good discussion during the rest of the seminar.