Federal Trade Commission

NYSBA International Law and Practice Section
October 20, 2006
Shanghai, China

Adoption of Trade Regulations in China, Scope and Effect: An American's View

Remarks of Pamela Jones Harbour
Commissioner, Federal Trade Commission

I am delighted to meet with you here in Shanghai and to provide some thoughts on the development of China's draft Anti-Monopoly Law. My remarks today reflect my personal views and not necessarily those of the Federal Trade Commission, any of its other Commissioners, or the government of the United States.

The draft Antimonopoly Law represents a ten-year effort to formulate a comprehensive competition law that is expected to bring some cohesion to the existing Chinese competition law regime. I appreciate the resources that the Chinese government has devoted to crafting a competition law that has the potential to contribute to the growth of the Chinese economy and the welfare of its people. The transparency of the drafting process and the willingness of the Chinese government to seek advice from foreign competition officials and experts are especially commendable. U.S.

competition law. Exempting them from competition law coverage solely because of their status as government owned or controlled enterprises would likely harm both competition and consumers.

Although successive drafts of the Anti-Monopoly Law that the Chinese government has shared with us indicate that the drafters have benefitted from external advice, there are still provisions that would benefit from further modification. Today, I

Competitive conduct frequently looks like exclusionary conduct, because aggressive competition may harm less efficient firms. These less efficient firms may in turn complain to competition authorities to seek government protection from legitimate competitive pressures. But the goal of competition law should be the protection of the competitive process rather than individual firms. U.S. law does not protect less efficient firms from legitimate, vigorous competition from another firm, even if that firm holds a dominant or monopoly position. Determining whether a competitor is competing aggressively or acting anticompetitively is a challenge that is best met by the application of objective, economically-based, and transparent standards.

We want businesses - all businesses, including firms with dominant positions - to compete vigorously, day in and day out. We want them to continue to invest in research and development that may generate new or enhanced products and services. In the long run, these practices tend to foster innovation and promote economic growth and well-being. But if some firms perceive that their routine, day-to-day decisions are being second-guessed by enforcers -- just because their companies may hold a dominant position -- we should not be surprised to see them competing less vigorously, or taking fewer R&D risks. As a result, competition may be suppressed, not enhanced, by treating dominant firm conduct as automatically suspect.

Determination of Dominant Market Position

The draft Anti-Monopoly Law presumes a dominant market position based on the market share of a single firm or the combined market shares of two or three firms. Without further analysis, such presumptions can yield an erroneous conclusion because high market share by itself is not inevitably a reliable indicator that a firm has market power in any particular market. Under the laws

of

Accordingly, the legal standards for market dominance should clearly indicate that the determination is based on the establishment of durable market power – the ability to maintain price over competitive levels for a significant period of time – which will be based on an economic analysis of the range of factors generally considered in analyzing market power. Alternatively, if some presumptions based on market shares are deemed necessary, they should be rebuttable presumptions. A rebuttable presumption provides an opportunity for a firm to offer proof either that it does not possess market power or that any market power it does possess is not durable.

Before leaving this topic, I should add that it may be appropriate and helpful to the business community for the Anti-Monopoly Law or implementing regulations to establish a safe harbor. That is, a market share below which there will not be a finding of a market dominant position. In the United States, we do not bring enforcement actions challenging unlawful monopolization where the market share of a firm is less than 50% because a firm with a market share below this level is unlikely to have durable market power.

Prohibited Conduct

The draft Anti-Monopoly Law prohibits a firm with a dominant market position from engaging in certain specified conduct. Each example of abusive conduct is a type of conduct that will usually constitute legitimate competitive behavior. Some of the prohibited conduct can be anticompetitive under particular circumstances. These provisions of the draft Anti-Monopoly Law are deficient because they fail to distinguish clearly legitimate competitive conduct from that which injures competition. Without careful economic analysis of competitive effects, these prohibitions pose a significant risk of interfering with procompetitive conduct by, for instance, undermining a

firm's ability or willingness to provide product innovations or to adopt more efficient production or distribution methods.

An example of prohibited conduct in the draft law that raises these concerns is the prohibition of "unfair" high pricing. U.S. competition law does not limit the price that a monopolist is permitted to charge – a monopolist may charge as high a price as the market will tolerate. Risky investments in innovation are often undertaken only because of the prospect of receiving a large return from a major technological breakthrough or a popular new consumer product. As our Supreme Court has observed:

> 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.[2]

Unless the monopolist sells its product in a market characterized by barriers to entry, high prices normally will attract firms to enter the market – especially when the new entrant can offer a lower price, a better product, or enhanced services. New entry can restore the competitive equilibrium, tending to drive prices back toward competitive levels without the need for government intervention. Allowing market forces to work rather than resorting to enforcement to control supra-competitive prices avoids burdening competition officials with the difficult and unnecessary task of monitoring prices and evaluating whether they are "unfair" or "excessive." In the United States, the FTC or DoJ are not asked to set "fair" prices because it is beyond the agencies' core competence and a diversion of their limited enforcement resources.

---

[2] Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

The

The ICN's Recommended Practices provide that each jurisdiction's merger review rules should seek to screen out transactions that do not have an appreciable effect on competition within the jurisdiction. Notification of a transaction should not be required unless the transaction is likely to have a significant, direct, and immediate economic effect in the jurisdiction concerned. The ICN recommends that notification thresholds require that at least two parties to a transaction have significant local activities or that if local nexus requirements are based on a single party's domestic contacts, the thresholds should focus on the local activities of the acquired business and use thresholds that are sufficiently high to avoid notification of transactions without potential material effect on the local economy. The ICN Recommended Practices specifically state that the most suitable thresholds are based on significant local sales or asset levels within the jurisdiction.

U. S. premerger notification thresholds provide that the parties must have combined U.S. sales or assets exceeding $113.4 million and the acquired party must have assets or sales in or into the U.S. exceeding $56.7 million. In addition, the U.S. ensures that foreign transactions have an adequate nexus with the U.S. by exempting certain foreign transactions from notification obligations. For example, the U.S. exempts acquisitions of foreign assets where those assets generate less than about $57 million in annual sales in the U.S., and acquisitions of stock in a foreign company when the acquired company has less than about $57 million in assets in the U.S. or less than $57 million of annual sales in or into the U.S. These thresholds are adjusted annually based on changes in the Gross National Product of the United States.

The premerger notification thresholds in the draft Anti-Monopoly Law appear to be inconsistent with the ICN Recommended Practice concerning local nexus to the reviewing jurisdiction because they would require reporting of merger and other transactions that do not have

to competition issues enables the agency to focus on its core area of expertise, promotes public confidence in the economic basis of competition law, and avoids confusion.

The draft law should clarify

of intellectual property rights, and more specifically on two aspects of them: how they affect standard setting; and how these rights fit in with the overall competition enforcement policy.

Regarding the latter, economists have long known that innovation is a principal factor in fostering a dynamic, growing economy. Innovation promotes consumer welfare and economic efficiency in a number of ways. It drives down costs through the development of more efficient production and distribution techniques. It stimulates economic growth by bringing desirable new products into the market. It also may limit the creation and exercise of market power by fostering the development of new technologies that permit entrants to leapfrog the advantages of and the entry barriers enjoyed by entrenched dominant firms. One of the cornerstones of innovation is intellectual property, because it is both a key input into and a byproduct of successful innovation. Intellectual property, therefore, is a highly valued asset in every economy, and it ha

Scope of Protection for Intellectual Property Rights

Given the importance of intellectual property in fostering economic progress, one might wonder whether the world's economies might progress even faster if intellectual property were more freely available for others to use and build upon – *i.e.,* treated more like a public good than private property. While that idea has some simple appeal, an erosion of intellectual property rights would be extremely shortsighted. There is an international consensus today that a strong intellectual property regime is needed to provide an incentive to undertake costly and risky investment in innovative activities.

It can be very expensive to conduct the research and development that is necessary to come up with new products and technologies. It is quite common for there to be many failures before a successful innovation is achieved. There would be little incentive for firms to make such a risky investment in research and development if others could freely copy or use a successful innovation and prevent the inventor from realizing well-earned rewards. Effective intellectual property rights are one of the most important means for providing those incentives. In the United States, intellectual property rights laws give innovators the right to exclude others from using their inventions for a specified period, and thus guarantee the innovators an opportunity to realize a return commensurate with the value of the invention and the risk that was undertaken. Protecting intellectual property4.68 0 Tdto79

First, the inventor has a legal right to exclude others from using that invention for an appropriate period of time. As a necessary corollary, antitrust liability for unilateral, unconditional refusals to license patents should not play a meaningful role in the interface between IP rights and antitrust protections.

Inte

aspects of our entertainment. They are promulgated by governments,[10] by private groups, or arise from their spontaneous acceptance by the marketplace.

In the United States, standard setting is largely done by private entities. This private standard setting process enhances competition in most instances. It offers the greatest likelihood that an efficient standard will emerge – perhaps through consensus standard setting, or through competition between standards, or through some combination of both processes. A market economy is based on the premise that competition is more likely than other forms of economic organization to maximize economic progress and produce the optimal outcome for consumers with respect to product price, quality, and innovation. That premise should be valid regardless of the degree of standardization that is appropriate in an industry. Consensus acceptance of a standard within a market indicates that there is more than one way of providing an element of a product or service that consumers want, but the market would be better served by use of a common method. That does not mean that competition in the technology that is being standardized is no longer important. At the standard setting stage there is competition among alternative technologies to be included in the standard. There is no reason that competition to be included in a standard should be any less market driven than competition in the downstream market for products or services that incorporate the standard. Given the basic premise of a market economy, we can expect market participants in a competitive system to select the technology that is most likely to meet consumer needs and desires i

always will be competition to improve upon the standard and, perhaps, to supersede it. Here again, the preference of the market is an excellent arbiter of which technology prevails.

Antitrust Implications of Standard Setting

Standard setting normally is an efficiency-enhancing activity and, as such, usually does not raise significant antitrust concerns. On the contrary, standard setting usually is considered to be procompetitive. However, under exceptional circumstances, antitrust concerns can and do arise. The standard setting process may raise such concerns if it involves unreasonably exclusionary conduct or anticompetitive collusion. For example, in one American case,[11] makers of steel conduit were found liable for "packing" an SSO meeting with its agents and thereby improperly obtaining an SSO decision that limited the standard to steel conduit, thereby excluding a perfectly viable alternative product (plastic conduit) from being used in the building industry. This is an example of an artificial restraint on entry, resulting in unreasonable exclusion from the market.

There are also examples of unilateral exclusionary conduct in the standard setting context. In particular, an intellectual property rights holder that takes part in standards setting may have an incentive to improperly obtain or increase the market power of its IP rights. Such a strategy may involve the IP holder: misleading a standards-setting body regarding its IP interests, leading to the adoption of a standard that "reads on" the holder's IP, and then subsequently exercising that new market power by demanding unexpected licensing royalties after a standard has been set and producers have incurred costs that "lock them in" to the standard. The FTC recently brought two cases involving that sort of conduct, one involving a governmentally

reduced, and the rate of economic progress could well slacken. The derogation of IP rights by standards organizations also could make IP owners more reluctant to participate in standard setting. We would thus lose some of the benefits of standardization, and the standards adopted likely would be less efficient. Finally, weakening of IP rights are likely to have a negative impact on technology transfers and foreign investment.

This issue arises in the context of compulsory or mandatory royalty-free licensing of intellectual property rights, particularly patents. Compulsory licensing has been advocated by some Chinese officials. Under U.S. law, a firm's unilateral and unconditional refusal to license its intellectual property, standing alone, has not been an antitrust violation. U.S. antitrust officials from

technology. That might lessen prib1That m

Engineering ("ASSE"),[20] the FTC challenged ASSE's policy of refusing to develop a standard for a product that is patented or manufactured by only one manufacturer, regardless of its merits. The case was settled with the issuance of a consent order that prohibited such blanket exclusions.

At the same

---

standard have an understandable interest in knowing in advance what it might cost to use a standard. Likewise, standards organizations should be in a position to make informed decisions about the cost effectiveness of alternative standards. Accordingly, some standards organizations have a policy of requiring participants to disclose their intellectual property rights, even including applications for such rights, in technology being considered for inclusion in a standard. That may be a prudent policy

ty.

antitrust laws can counteract this competitive concern without undermining legitimate protection for intellectual property rights or deterring legitimate, procompetitive standards setting activity.

In short, the interests of intellectual property rights holders, affected producers, and consumers are often best mediated through a competitive, market-driven standard setting process

rt4 0rar7.t22 Tw 3.5 Td(tercrar7.tos)Tj0.636 Tdrarar7.te

characterized by transparency, arms' length negotiations, informed decision making, efficient [illegible]

licensing