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I. INTRODUCTION

In this article, I will examine the landmark case where the Shanghai High People's Court ruled against the Chinese subsidiaries of Johnson & Johnson for resale price maintenance violation, in favor of the plaintiff, a Chinese distributor, Beijing Ruibang Yonghe Technology and Trade Co. Ltd.

This case is significant because it is the first case where a private antitrust litigation has been successful (on appeal) in China, since the Chinese antitrust legislation, the Anti-Monopoly Law ("AML") came into effect half a decade ago. There has not been a shortage of plaintiffs in China seeking to sue competitors and suppliers under the AML, but the Chinese courts have so far taken a cautious approach, willing to entertain lawsuits in only a few instances.[2]

Antitrust law, as an area of law, is still relatively new in China. Law departments in most universities have not yet offered standalone courses on the AML and this, in turn, may have slowed the growth of antitrust expertise in the Chinese judiciary. At present, cases involving Chinese antitrust disputes are adjudicated by the judges in charge of intellectual property law. So, given these limitations, this successful antitrust litigation is a major milestone by the Shanghai court, and an encouraging sign that Chinese antitrust regime is developing, even at a gradual pace.

The Shanghai court case is also important because it reflects on how an emerging antitrust regime deals with vertical restraints. In several other new antitrust jurisdictions in neighboring countries in Asia, resale price fixing has been treated very differently: Singapore's Competition Act takes a benign approach towards resale price maintenance; Hong Kong's Competition Ordinance is silent on whether vertical price-fixing is specifically prohibited.[3]

Since the AML came into effect, there have been many administrative enforcements involving price-fixing cartels among competitors, including the most recent case against foreign milk producers which produced fines of more than U.S.$100 million, but the *Johnson & Johnson* case is one of the first major cases involving supplier and distributor in a vertical context.[4] The

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[2] A high profile case was the court litigation involving China's top online companies, Qihoo 360 and Tencent, which have been embroiled in antitrust dispute involving abuse of market dominance.

[3] Compared to the prohibitions in the horizontal context under the Hong Kong Competition Ordinance, where specific instances of hardcore violation such as price-fixing and market allocations among competitors are listed.

[4] There was another recent enforcement against Chinese wine makers (Moutai, etc.) by the antitrust enforcement agency, the National Development and Reform Commission (NDRC), but the detailed facts and reasoning were not published.

judicial treatment in this case should provide guidance for how the Chinese judiciary[5] and enforcement agencies might, in the future, approach similar resale price maintenance violations.

II. BACKGROUND AND FACTS OF THE CASE

The dispute involved Johnson & Johnson Medical (Shanghai) Ltd. and Johnson & Johnson Medical (China) Ltd (collectively "J&J') and Beijing Ruibang Yonghe Technology and Trade Co. Ltd ("Rainbow"), a Beijing-based distributor of J&J.

Rainbow was a distributor of J&J for 15 years, selling Johnson & Johnson suturing products. Despite being a distributor for many years, the distribution contract was renewed for a one-year period, renewable annually. This is typical of most distribution arrangements in China, where long-term distribution contracts are rare.

Under the distribution contract, Rainbow was granted a restricted sales territory[6] to sell Johnson & Johnson's Ethicon branded products to designated hospitals in Beijing, with a prescribed resale price set by J&J. In March of 2008, Rainbow won a bid to supply medical sutures in a public tender by Peking University People's Hospital. A month later, J&J issued a warning notice to Rainbow for selling below the resale price prescribed under its distribution contract. Subsequently, two months later, J&J terminated Rainbow's distributorship rights, and refused to supply[7] to Rainbow despite receiving its purchase orders. And when the annual distribution contract was due to expire, J& J did not renew the distribution contract with Rainbow.

Interestingly, J&J amended its distribution contract the next year, in 2009, with the minimum resale price limitation policy removed. Conceivably, this could have been triggered by the need to be in compliance with the AML, which came into effect in August 2008. Prior to the AML coming into effect, vertical price-fixing had been a grey area of law, governed by the more traditional legislation in China—the Price Law[8]–as well as associated regulations[9] prohibiting RPM where the supplier had a dominant market position. But this rule against RPM had not been rigorously enforced by the Chinese regulator, which might have led many companies, including major multi-national corporations ("MNCs) like Johnson & Johnson, to ignore the risk of illegal RPM in China.

By contrast, other MNC's, prior to the enactment of the AML, used a more cautious compliance measure, i.e. to provide a "suggested" or "recommended" resale price, but avoid making it mandatory for distributors. However, this was not necessarily a safe approach. If failure to follow such suggested or recommended price could have resulted in punitive measures

[5] Chinese court system is not bound by precedents under *stare decisis* doctrine, but given the amount of analyses and work done by the Shanghai judges in the *Johnson & Johnson* case, it is likely the case would provide useful guidance for other courts in future cases.

[6] It is worth noting the sales territorial exclusivity arrangement was not challenged as a possible abuse by J&J of its market dominance, which is prohibited under Chapter 3 of the AML.

[7] Query - whether this could have been actionable for abuse of dominant market position under the AML? This is further discussed later in the article.

[8] This is an older piece of legislation, based on governmental policies centered on socialist style price control of essential goods and services.

[9] The corresponding regulation was repealed in 2011.

from the supplier (or conversely, the other side of the coin, withholding of sales incentives or year-end bonus that are generally made available to most distributors), then it was quite likely that Chinese courts would take a strict view towards such practice, and rule it as a form of RPM, even though in disguised form. (In fact, in the court proceedings, Rainbow counsel alleged that J& J had not only resorted to such punitive measures against their distributors, using warnings, threatened suspension of distributorship rights, and eventually termination/non-renewal of distribution contracts, as well as adopting an electronic commerce system to monitor the pricing of distributors.)

In this particular case, Rainbow filed a lawsuit against J&J in Shanghai No.1 Intermediate People's Court[10] in August, 2010, seeking compensation for losses caused by J&J because of its RPM conduct, in breach of Article 14(2) of the AML. In the first instance court, the Shanghai No.1 Intermediate People's Court rejected the lawsuit on the ground that Rainbow failed to prove that the RPM agreement had excluded competition.

On appeal to the Shanghai High People's Court[11], the judges overturned the judgment in the first instance court, and made the finding that J&J violated the RPM provision in the AML. The appeal court awarded compensation in favor of the plaintiff for the loss of profits from selling suture products.

III. THE TWO MOST CONTESTED ISSUES

The most highly contested issues in this court case were:

1. Was it sufficient to establish that there had been resale price maintenance, which is specifically prohibited under Article 14 of the AML, or was it necessary, in addition, to show that the illegal RPM had an anticompetitive effect; and
2. If proof of anticompetitive effect was required, on whose shoulders, the plaintiff or defendant, did the burden of proof lie?

A. Applying the AML to Vertical Price-fixing

On appeal, the Shanghai High People's Court concluded that proof of anticompetitive effect was required, even if vertical price-fixing was manifest. The court reached this conclusion after examining Article 13 of the AML. Article 13 of the AML defines horizontal anticompetitive[12] agreements, including the typical "hardcore' violations such as price-fixing and market allocations among competitors. Article 13 ends with a proviso that defines anticompetitive agreement or conduct as one that "eliminates or restricts competition."

The Shanghai appeal court judges reasoned that, although Article 14 does not specifically contain a similar proviso for vertical anticompetitive effects, the same principle should apply to

[10] The intermediate people's court is the court of first instance for competition law cases brought under the AML

[11] Shanghai High People's Court, *Bangrui Yonghe Technology Trading Co., Ltd. v. Johnson & Johnson (Shanghai) Medical Equipment Co., Ltd. and Johnson & Johnson Medical (China) Ltd.*, [2012] Hu Gao Min San (Zhi) Zhong Zi No. 63, August 1, 2013 (hereinafter "Judgment").

[12] The AML refers to anticompetitive agreements as "monopolistic" agreements, which seems confusing as the term "monopolistic" is used in economics to characterize monopolistic market, as compared with oligopolistic market or perfect competition.

vertical price-fixing. In particular, they supposed that the lawmakers must have intended the definition of anticompetitive agreements or conduct to apply across both horizontal and vertical relationships, and just wanted to avoid the inconvenience of repeating the definition in every section of the AML. A comparable approach can be seen with the definition of a "business operator" in Article 12 of Chapter 1 of the AML, as the AML doesn't repeat the definition in every part of the AML where the same term is used.

B. The Burden of Proof

However, this literal interpretation of the AML, which seems correct, could impose a heavy onus for plaintiffs in these cases. Where agreement or conduct involves hardcore antitrust violations such as price-fixing or production quotas, it is hard to see why further proof of anticompetitive effect should be established. At least with regard to horizontal restraints, the Supreme People's Court has issued guidelines[13] ("Supreme People's Court Guidelines) that shift the burden of proof to the defendant.

But this evidentiary rule in the Supreme People's Court Guidelines does not apply to vertical relationships. Hence, the Shanghai court concluded that the onus falls on the plaintiff, not only to establish that there has been RPM, but also that it is anticompetitive in effect. The Shanghai court based its reasoning on the fundamental principle of Chinese civil procedural law, which is that the onus is on the party making the allegation, save where legislation specifically provides otherwise (as with horizontal agreements or conduct under the Supreme People's Court Guidelines).

This conclusion is in contrast to the European Union approach, where, when determining that RPMs (or other forms of horizontal restraints) have the "object" of preventing, restricting, or distorting competition, the enforcement agencies do not have to prove anticompetitive effects.[14] Consequently, the Shanghai ruling in the *Johnson & Johnson* case could raise the bar for future plaintiffs, particularly distributors and other stakeholders such as downstream consumers affected by vertical price-fixing. If the same approach is followed by the Chinese enforcement agency in charge of the AML, this could lead to Type II errors—under-enforcement of antitrust cases–if enforcement officials become more hesitant to pursue cases because they have to carry the burden of proving anticompetitive effects.[15]

IV. THE ANALYTICS USED FOR ASSESSING THE ANTICOMPETITIVE EFFECTS

In the J&J case, the Shanghai Court formulated an analytical framework for assessing competitive effects based on four factors:

- whether there was sufficient degree of competition in the relevant market;

[13] Provisions by the Supreme People's Court on Several Issues concerning the Application of the Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct, [2012] Judicial Interpretation No. 5, May 3, 2012. , paragraph 7.

[14] Instead, the defendant can seek to defend itself by pleading pro-competitive benefits under Article 101(3) of the EU Treaty (Treaty on the Functioning of the European Union); *see* analysis in RICHARD WHISH, COMPETITION LAW pp. 116 - 117 (2009).

[15] Compare with EU under the 2010 Guidelines on Vertical Restraints at paragraph 223 where RPM is treated as a hardcore violation, not subject to rule of reason.

- whether J&J had a strong market position;
- the motive of J&J in undertaking RPM; and
- whether anticompetitive effects were outweighed by pro-competitive effects.

The court articulated that these factors were not exhaustive, but were the key ones for the purpose of the present case.[16] As such, these factors will no doubt be of relevance in future court cases or enforcement actions. Each is discussed below:

A. First Factor: Is There Sufficient Inter-Brand Competition?

The Shanghai court articulated the presence of sufficient competition in the market as a "foremost condition" in assessing whether an alleged RPM conduct is anticompetitive. This requirement is justifiable, as the presence of inter-brand competition in the market should provide competitive restraints on the supplier, so that the lack of intra-brand competition should not of itself be a cause for concern.

B. Second Factor: Is There Overlap Between RPM Prohibition and Abuse of Market Dominance?

In the proceedings, the court in Shanghai questioned whether there was proof of strong market dominance on the part of J&J. The standard of proof by which the court required the plaintiff to demonstrate the anticompetitive effect of the alleged RPM conduct seemed rigorous, coming close to the point where there is some overlap with Chapter 3 of the AML.

In fact, the question arises as to whether, by insisting on such proof of dominance, the Shanghai court is subjecting the plaintiff to a burden of proof even more rigorous than that applicable under Chapter 3 of the AML, which governs abuse of dominant market position. If so, then the effect of the Shanghai court judgment would seem to create an overlap between the RPM prohibition under Article 14 and the prohibition against abusive conduct by dominant companies under Chapter 3. In contrast, under the European Union, these would be separately regulated under Article 101 (for anticompetitive agreements) and Article 102 (for unilateral conduct).

Interestingly, when analyzing this second factor involving J&J's market position, the Shanghai court stopped short of using the verbiage associated with dominance analysis. Instead, the judges formulated the requirement in the second factor as "whether the defendant has a **strong** market position" (emphasis added). The term "strong market position" does not appear in the dominance provisions in Chapter 3 of the AML. This begs the question of what criteria is used to determine "strong" market position for the purpose of showing anticompetitive effect in RPM cases.

By contrast, in the abuse provisions in Chapter 3 of the AML, there are both quantitative criteria (more than 50 percent market share by a single firm, or two-thirds or three-quarters market share for joint dominance involving two or three companies respectively), as well as qualitative criteria (such as the degree of dependence of the customer on the supplier, the

[16] *See* Judgment at p. 40.

supplier's ability to control the raw materials market, the financial power and technological resources of the supplier, and existence of barrier to entry).

In fact, examining closely the Shanghai court judgment, it would appear that despite the different verbiage (i.e. "strong" market position, and not "dominant" market position), the judges arrived at the conclusion that J&J had a strong market position looking at factual circumstances that seem similar in nature to proving market dominance under Chapter 3 of the AML:

- strong market share of J&J;[17]
- entry barrier for medical products due to regulatory restrictions;[18]
- the degree of dependence on J&J's brand;[19]
- price-setting ability, in particular the fact that the resale price of J&J products in China has remained constant for 15 years, which is quite amazing;[20] and
- technological superiority of J&J products.[21]

Based on the evidential factors that the court identified in this case, one wonders whether the term "strong" market position as espoused by the Shanghai judiciary is, in fact, equivalent to the "dominant" market position as defined under Chapter 3 of the AML, and whether the difference is merely of semantics. Although the factors examined by the Shanghai judges do not correspond exactly to the test of dominance set out in Chapter 3 of the AML, there is nevertheless a high degree of overlap. If so, then what the Shanghai judiciary has done in effect is to add a high degree of rigor to proving illegal RPM, with a strict test of anticompetitive effect that is almost tantamount to establishing dominance on the part of the defendant.

If proving an allegation of RPM is as onerous as an allegation for unilateral abuse under the dominance chapter of the AML, then an interesting question is whether, on the facts of this case, the plaintiff could have pleaded that J&J had committed an abuse of dominance. For example, J&J withheld a deposit of RMB 20,000[22] belonging to Rainbow when J&J found out that the distributor had sold the J&J products in Beijing outside of Rainbow's assigned distribution territory.

On the other hand, a defendant under an action for abuse of dominance can avail itself of possible defenses in the form of "legitimate reason" for the alleged abuse.[23] While pro-competition and pro-efficiency exemptions are available for anticompetitive vertical (as well as horizontal) agreements under Article 15 of the AML, the room for pleading an exemption under

[17] *See* pp. 47 - 48, 50 of the Judgment; *see also* the CR4 data (40 percent to 70 percent) and HHI data (≥ 3,000) and the market share > 50 percent as submitted by plaintiff on pp. 23 - 25; this is similar to paragraph (1) of Article 18, and Article 19 of the AML.

[18] *See* p. 44 of the Judgment; this is similar to Article 18(5) of the AML.

[19] *See* pp. 45 – 46, 49 - 50 of the Judgment; this is similar to paragraph (4) of Article 18 of the AML.

[20] *See* pp. 44, 48 of the Judgment; this is similar to paragraph (2) of Article 18 of the AML.

[21] *See* pp.47 - 48 of the Judgment; this is similar to paragraph (3) of Article 18 of the AML.

[22] *See* p.3 of the Judgment.

[23] *See* Article 13 of the NDRC Anti-Price Monopoly Regulation, and James H. Jeffs, *A Short Comparison of Certain Provisions of the new NDRC and SAIC Regulations*, (2) CPI ANTITRUST CHRON. (February 2011).

Article 15 appears to be more challenging, compared to showing that there is "legitimate reason" (such as customary business practice) for excusing what would otherwise be an abuse of dominance. (The Shanghai court also examined a pro-efficiency plea by J&J, but dismissed the evidence tendered—see further discussion below in Section D.)

C. Third Factor: Is The Motive Relevant for Assessing Competitive Effects?

The third factor cited by the Shanghai court in assessing whether there was an anticompetitive effect was the presence of motive in perpetrating RPM.

It is hard to understand why motive should be relevant, if, following an effect analysis, the first two factors have already been established by a plaintiff. Given the relatively high thresholds which had to be crossed in proving that the defendant had a "strong" market position, it is difficult to grasp why the plaintiff still needed to overcome yet another evidential hurdle to show motive of RPM on the part of the defendant.

Perhaps the third factor of "motive" was included in the assessment by the Shanghai judges simply because there was overwhelming evidence that the plaintiff managed to adduce in this case against J&J. The judges may have referred to the presence of motive by J&J to reinforce the ruling, and give them a stronger basis to overrule the lower court.

D. Fourth Factor: Do Anticompetitive Effects OutweighPro-Competitive Effects?

The final factor involves a weighing of the competitive harms against any possible pro-competitive and pro-efficiency effects that the RPM might create. J&J argued that the RPM imposed by J&J on its distributors could enhance the promotion of J&J products and after-sale services. Looking at the available evidence adduced by the defendant, the plea for pro-efficiency appears to be a last straw effort.

The court ruled that the J&J brand for the medical products had already been entrenched in China after more than a decade of market presence. Therefore, the judges were not convinced that RPM was necessary to help the distributors in product promotion. The judges also opined that RPM was not necessary for encouraging after-sales service as each distributor had been allocated exclusive sales territory.

The Shanghai court's dismissal of the pro-efficiency plea by the defendant is a correct approach. If the plaintiff has to summon substantial evidence to establish the RPM is anticompetitive, then it is justifiable to require the defendant to produce adequate counter-arguments with supporting evidence to be allowed to overturn the plaintiff's case. On the judgment as published, the defendant's evidence appears flimsy and lacking in cogent arguments.[24] The judges expressed the opinion that the pro-efficiency effects were "not obvious." A plea for pro-efficiency effect cannot be speculative.

Interestingly, the court did not address in depth any of the arguments available under Article 15 of the AML that provide exemptions for anticompetitive agreements. It would be

[24] *See* p. 52 of the Judgment.

useful if the judgment had shed more light on how the pro-efficiency and other grounds for exemption under Article 15 of the AML should be applied, and how it works.

IV. THE SIGNIFICANCE FOR PLAINTIFFS

A. Raising the Bar

The approach taken by the judges in this case basically raised the bar for plaintiffs in alleging RPM. First and foremost, the court on appeal, supporting the approach of the first instance court, insisted on proof of anticompetitive effects for vertical price-fixing. This approach differs from the treatment of RPM as a hard-core violation under the EU regime, and would be closer to the jurisprudential developments in the United States where, in the *Leegin* case, the Supreme Court reversed a century-old precedent to hold that RPM must be analyzed under the rule of reason.

The Shanghai judges, in this case, emphasized that the first factor described above, i.e. a lack of adequate competitive constraints, was the first and foremost factor. Looking forward, one could conclude that only if the relevant market was found to be uncompetitive would the next steps be taken – i.e. examining the factors that are conjunctive requirements. A lack of adequate inter-brand competition by itself is not sufficient for the case to go forward. This would seem to imply that if, on examination, the first factor (i.e., sufficient market competition) has been ascertained, then the RPM would be treated as benign, and the case by the plaintiff would not succeed.

B. Does The Plaintiff, As a Party to the RPM Agreement, Have Locus Standi To Sue

Another key issue raised by the defendant in the *Johnson & Johnson* case was whether the plaintiff, being a willing signatory to the distribution agreement containing the RPM restriction, has standing to sue the other contracting party for antitrust violation. The defendant argued that the losses triggered by illegal RPM were suffered by the downstream consumers affected by the vertical price-fixing. However, this argument is flawed, as the immediate contracting party to the distribution agreement could be as much of an aggrieved person as the downstream consumers.

The court ruled in favor of the plaintiff on this point. It held that anyone who has suffered competitive harm, whether or not a party to the RPM agreement, has standing to sue. The court based its reasoning on several grounds, including the Supreme People's Court Guidelines as well as Article 50 of the AML which provides for private antitrust litigation. This decision is in line with the judicial and regulatory policies in other countries.[25]

V. CONCLUSION

Multinational companies doing business in China have not always taken a compliant approach towards vertical price-fixing. For legitimate business reasons, companies may have different rationales for wanting to fix the resale prices of their distributors. For example, a common rationale for RPM for foreign suppliers keen to break into the China consumer market is to provide generous advertising and promotional budgets to their distribution channels in China. Unfortunately, however, misapplications of such grants of advertising monies from

[25] EINER ELHAUGE & DAMIEN GERADIN, GLOBAL COMPETITION LAW AND ECONOMICS, pp. 645-646 (2007).

suppliers have frequently occurred, where the distributors used the grants to undercut prices, instead of spending them on advertising and promotion.

Another scenario where MNC's have had problems that RPM may assist with involves price-cutting by unauthorized distributors, sometimes leading to the "cheapening" of what would otherwise a prestigious foreign brand. Foreign brands that rely on OEM producers in China are particularly vulnerable, as it is harder to control the parallel sales by the OEM makers. Brand prestige can be associated with premium pricing, especially in the fashion industry and other B-to-C sectors. As a result, this could be another reason for resorting to RPM to maintain the perception of brand quality with premium pricing.

Whatever the business rationales for wanting to maintain resale pricing, the *Johnson & Johnson* case is a wake-up call, reminding businesses that violations involving vertical relationships will not be tolerated under the Chinese antitrust regime.

Looking at the case in depth seems to signify, at least as far as the Chinese judiciary is concerned, that the thresholds and burden of proof in vertical price-fixing cases will be calibrated somewhere close to violations involving abuse of market dominance, compared with the relatively easier standard of proof involving horizontal price-fixing and other cartels among competitors. In these latter cases, in contrast to abuse of dominance cases, the burden of proof shifts to the defendant to show that the agreement is not anticompetitive, once the plaintiff has shown the presence of price-fixing agreements.

So between these two ends of the spectrum—the onerous proof of market dominance for unilateral conduct required under Chapter 3 of the AML, and the "guilty-unless-proven-otherwise" approach under Article 13 for horizontal violations—it would seem RPM in China lies closer to the former. Plaintiffs may need to engage economists for the effects analysis (both J&J and Rainbow did so in this case). Going forward, the use of economic analysis will no doubt gain in importance in the Chinese antitrust regime.

For multinational companies operating in China—especially with increasing regulatory enforcements highlighted by the multi-million-dollar fines in the milk powder cases—this means there is a need for stricter vigilance. It should be worthwhile extensively reviewing existing compliance programs in China to ensure regulatory compliance.