BEYOND A SNAPSHOT: INSIGHT OF THE FIRST JUDICIAL REVIEW CASE OF RPM ADMINISTRATIVE SANCTION DECISION IN CHINA

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I. INTRODUCTION

The sharp divergence between the courts' approach and the antitrust enforcement agencies' approach towards the application of law on resale price maintenance ("RPM") practices has existed for a long time.

The antitrust enforcement agencies' approach and practice is: vertical agreements (i) fixing the price for resale or (ii) restricting the lowest price for resale (hereinafter collectively referred to as "RPM agreements") which are explicitly listed under Article 14[2] of the Anti-Monopoly Law ("AML") of China as monopoly agreements. Unless the undertaking can prove that the RPM agreements concerned satisfy the conditions for individual exemption as set out under Article 15[3] of the AML, the agencies' finding generally will be that the RPM agreements constitute monopoly agreements directly pursuant to Article 14. This approach is referred to as "prohibited in principle, and exempted individually."

The courts' approach and practice is: the RPM agreements listed under Article 14 of AML cannot be readily regarded as monopoly agreements, but merely are types of agreements that may constitute monopoly agreements; whether such types of agreements constitute monopoly agreements depends on whether the RPM agreements in question satisfy the definition of monopoly agreement under Article 13(2)[4] of the AML. Typically, some courts in their judgments held that whether RPM agreements constitute monopoly agreements shall be analyzed based on their effect of eliminating or restricting competition.[5] Such approach of the courts is understood as similar to the rule of reason analysis established by the U.S. courts in the *Leegin* case.

The above-mentioned divergence clashed upfront for the first time in the recent anti-monopoly administrative litigation case of Hainan province (*Hainan Yutai Technology Feed Co., Ltd. v. Hainan Price Bureau*). In December 2017, the Hainan Higher People's Court ("HHPC") issued the judgment at second instance (Administrative Judgment 2017 Qiong Xing Zhong No. 1180, hereinafter referred to as "Judgment No. 1180"), for the first time recognized the above-mentioned enforcement approach adopted by the antitrust enforcement agencies through judicial review. This case attracted much attention from antitrust practitioners in and outside of China.

As the attorneys representing the Hainan Price Bureau at second instance, we would like to analyze three major issues concerned in this case: (1) whether the RPM agreements stipulated in Article 14 of AML shall be analyzed further in conjunction with Article 13(2); (2) how to understand the definition of monopoly agreement under Article 13(2) of the AML; and (3) what are the competition impacts of the RPM clause in this case. Lastly, this article will briefly analyze the impacts of this case.

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2 Article 14 of the Anti-Monopoly Law sets out that: "[T]he following monopoly agreements between undertakings and trading counterparts shall be prohibited:
(1) fixing the price of commodities for resale to third party;
(2) fixing the lowest price for resale of commodities to third party; and
(3) any other monopoly agreements as defined by the anti-monopoly enforcement agency of the State Council."

3 Article 15 of the Anti-Monopoly Law sets out that: "[W]here an undertaking is able to prove that the agreement it has entered into falls under any of the following descriptions, the provisions of Article 13 and Article 14 shall not apply:
(1) where the objective is technological improvement or research and development of new products;
(2) where the objective is to raise product quality, lower costs, improve efficiency, standardize product specifications and standards or implement specialization;
(3) where the objective is to raise business efficiency of small and medium undertakings and to strengthen the competitiveness of small and medium undertakings;
(4) where the objective is to fulfill public interest such as energy conservation, environmental protection and disaster relief etc;
(5) where the objective is to alleviate serious drop in sale quantity or obvious over-production in times of recession;
(6) where the objective is to protect the legitimate interests in foreign trade and economic cooperation; or
(7) any other circumstances stipulated by the laws and the State Council.
Where the provisions of Article 13 and Article 14 do not apply under any of the circumstances stipulated in item (1) to item (5) of the preceding paragraph, the undertaking must also be able to prove that the agreement it has entered into will not severely restrict competition in the relevant market and that it will allow consumers to benefit from the interests arising therefrom."

4 Article 13(2) of the Anti-Monopoly Law sets out that: "[M]onopoly agreements referred to in this Law shall mean the agreements or decisions or other concerted actions that eliminate or restrict competition."

5 *Beijing Rainbow Yonghe Science and Technology Trade Company v. Johnson & Johnson Medical (Shanghai) Ltd., Johnson &Johnson Medical (China) Ltd.*, (2012) Hu Gao Min San (Zhi) Zhong Zi No.63.

II. BASIC FACTS

In April 2015, the Hainan Price Bureau received a complaint about suspected vertical price-related monopoly practices conducted by several fish feed manufacturers in Hainan Province. After its investigation, the Hainan Price Bureau found that eight major fish feed manufacturers in Hainan province all concluded RPM clauses in their distribution agreements, and the annual turnover of these eight fish feed manufacturers combined takes up to approximately 99 percent of the total annual turnover of Tilapia feed manufacturers in Hainan. Hainan Price Bureau imposed administrative sanction on seven of the manufacturers except one bankrupted and cancelled manufacturer.

The plaintiff in this case, Hainan Yutai Technology Feed Co., Ltd. ("Yutai"), is one of the sanctioned fish feed manufacturers. It explicitly concluded in its "Feed Products Sales Agreements" with the distributors that: "Party B (the distributor) will keep the rebates plan of Party A (Yutai) in confidential, and the sales price of Party B shall follow the guidance price offered by Party A. Otherwise, Party A has the right to reduce rebates" ("the RPM Clause"). Hainan Price Bureau found that the RPM clauses constituted monopoly agreements in violation of Article 14(1) of the AML, and ordered Yutai to cease the illicit conduct and a fine of CNY 200,000 (approximately U.S. $31,500). Yutai initiated a litigation in the Haikou Intermediate People's Court ("HIPC") in opposition to the sanction decision issued by the Hainan Price Bureau.

The HIPC, the court at first instance, held that to find a monopoly agreement under Article 14 of the AML, it cannot simply rely on the fact that an RPM agreement has been concluded. Instead, a further analysis as to whether such a price agreement has the effect of eliminating or restricting competition shall be performed. This court further concluded that, the RPM clauses in question did not have the effect of eliminating or restricting competition, thereby not constituting monopoly agreements. Therefore, the court held that the sanction decision shall be withdrawn.

The Hainan Price Bureau appealed to the Hainan Higher People's Court ("HHPC") in opposition to the judgment at first instance. In Judgment No. 1180, the HHPC upheld the "prohibited in principle, and exempted individually" enforcement approach, and further held that the judgment at first instance shall be overruled, and all claims of Yutai are dismissed accordingly.

III. ISSUE ONE: WHETHER THE RPM AGREEMENTS STIPULATED IN ARTICLE 14 OF AML SHALL BE ANALYZED FURTHER IN CONJUNCTION WITH ARTICLE 13(2)

While the court at first instance held that the RPM agreements stipulated in Article 14 of the AML shall be analyzed further in conjunction with Article 13(2), we tend to opine that this holding incorrectly interpreted Article 14 of the AML. The RPM agreements are prohibited in principle by Article 14, therefore there is no need to verify again. The main reasons are as follows.

Firstly, from the legislative language used by Article 14, the introductory phrase used to refer the three explicitly listed items is the "following monopoly agreements," and the phrase used to describe the conducts under item 3 is "other monopoly agreements." Thus, it can be inferred that the "following monopoly agreements" referred to in Article 14 comprise two types of monopoly agreements: monopoly agreements explicitly listed under items 1 and 2; and "other monopoly agreements" referred to in item 3 besides monopoly agreements listed under items 1 and 2.

Secondly, from the usage of punctuation marks in Article 14, it uses the "semicolon" as the conjunction in between the three items explicitly listed. According to Article 12(4) of the "Technical Specifications for Legislation (Trial) (I)" issued by the Standing Committee of the National People's Congress, in "multiple compound sentences, where the commas have been used within each of the parallel clauses, "the semicolons shall be used between the parallel clauses." Therefore, the three items listed under Article 14 are parallel. Given that item 3 has been explicitly listed as "other monopoly agreements," the item 1 and item 2 listed by this article shall be monopoly agreements as well.

Thirdly, judging from the language of other articles, the items explicitly listed under Article 14 shall be specific types of monopoly agreements as well. For example, for those agreements that do not apply to Article 13 and Article 14, the legislative language adopted in Article 15 of the AML is "agreements"; for the list of items to which the article might be applicable, the legislative language used in that article was "one of the following." On the other hand, Article 13 and Article 14 both adopt the following legislative language: "the following monopoly agreement," "..... other monopoly agreements." It can be seen that agreements explicitly listed under Article 13 and Article 14 of the AML, including RPM agreements, in principle, constitute monopoly agreements on their own.

Lastly, based on the legal system of the AML and the guiding ideology of the legislation, the types of agreements explicitly listed in Article 14 of the AML should also be understood as presumed to be consistent with the definition of a monopoly agreement under Article 13(2), without the necessity to verify again in individual cases. One of the guiding ideologies of the AML is: "The AML legal system must conform to international common practices, strictly prohibit the typical monopoly behaviors which are universally agreed upon by all countries in the world as restricting and eliminating competition...the institutional arrangements shall strive to be clear, impartial and appropriate, and easy to understand and apply."[6] Among the types of agreements explicitly listed in Article 13(1) as well as Article 14, all are typical monopoly agreements universally agreed upon by countries around the world as severely eliminating and restricting competition. For these types of agreements, the common legislative attitude of countries around the world is that they are illegal *per se*, prohibited in principle or presumed to be illegal, etc. Disregarding whether the agreements are explicitly listed in the AML and requiring all of them to be verified again under Article 13(2) will undoubtedly leave the type-setting efforts of the AML legislation on the sidelines, which are not in conformity with international common practices and not to mention the original legislative aim of making the system clear and easy to understand and apply.

The above-mentioned grounds of appeal and the statements of attorney have basically been supported by the court. The HHPC held in Judgment No. 1180 that: From the text of the Articles, firstly, the word "prohibit" is used before the items listed, which shows the negative attitude of the AML towards monopoly agreements; secondly, the Articles refer the listed items to as "monopoly agreements" rather than "agreements," which logically accords that what the Articles explicitly list are monopoly agreements; thirdly, the Articles expressively grant the antitrust enforcement agencies of the State Council the power to identify other monopoly agreements, which shows that the antitrust enforcement agencies enjoy certain discretion in identifying monopoly agreements in this specific field of antitrust law. Therefore, the AML directly regards such RPM agreements as monopoly agreements which shall be clearly prohibited.

IV. ISSUE TWO: HOW TO UNDERSTAND ARTICLE 13(2) OF THE AML

Another important issue involved in this case is how to understand article 13(2), the "monopoly agreement" definition clause.

In the first-instance judgment, the HIPC held that to determine whether an agreement can be categorized as the monopoly agreement "fixing the resale price to third party" under item 1 of Article 14, it is necessary to fully consider whether such conduct has the effect of eliminating or restricting competition. The HIPC further held that factors such as the scope of relevant market, the market share of Yutai in the fish feed market, the specific degree of competition in the fish feed market, the impact of the agreement on the supply volume and price, and the scale of Yutai's business, etc., shall be fully evaluated in deciding whether the contractual terms concerned have the effect of eliminating or restricting competition.

Although the second-instance judgment did not touch upon this issue directly, we tend to think that this issue is worth exploring, and thus would like to briefly present our opinions.

A. Can "Eliminate or Restrict Competition" under Article 13(2) be Equal to "Have the Effect of Eliminating or Restricting Competition"?

We tend to opine that equating "eliminate or restrict competition" with "have the effect of eliminating or restricting competition" is actually a narrowed interpretation of the law.

Firstly, the text of article 13(2) does not limit "eliminate or restrict competition" to effects. Having a thorough reading of the AML, it is obvious that the omission of the word "effect" under Article 13(2) is not due to a legislative error, nor due to the then legislative techniques. For instance, both item 3 of Article 3 and Article 28 of the AML explicitly stated the word "effect," i.e. "concentration between undertakings that have or may have the effect of eliminating or restricting competition." Instead, the text of Article 13(2) does not have the word "effect." Thus, the definition under Article 13(2) cannot be equivalent to "have the effect of eliminating or restricting competition."

Secondly, reading the language of Article 13(2) in light of the legislative history, it can be easily inferred that the phrase "eliminate or restrict competition" refers both to "effect" and "aim." A presentation titled the "Background of the Enactment of the Anti-Monopoly Law (Draft)" posted on the National People's Congress' website classified monopoly agreements into two categories: (1) those reached with an aim

6 *Explanation on the "Anti-monopoly Law of the People's Republic of China (Draft)"*, the website of the National People's Congress, http://www.npc.gov.cn/wxzl/gongbao/2007-10/09/content_5374671.htm.

to eliminate or restrict competition; and (2) those that have an actual effect of eliminating or restricting competition.[7] And the then Minister of Legislative Affairs Office of the State Council, Mr. CAO Yongtai, explicitly stated in his presentation before the National People's Congress titled "An Explanation of the Background of P.R.C Anti-Monopoly Law Draft" that monopoly agreements are those reached with an aim to eliminate or restrict competition.[8]

Thirdly, the Treaty on the Functioning of the European Union, an important reference of the AML, also classifies monopoly agreements into those "by object" and those "by effect." Specifically, Article 101(1) sets out that: "the following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which……"

Lastly but not the least, back to the AML, all of the agreements listed under Article 13(1) and Article 14 share a commonality, i.e. they tend to be severely anti-competitive. Hence, the objects of these agreements are probably anti-competitive. For instance, the price fixing agreements between competitors always eliminate the price competition between competitors; the market allocation agreements between competitors always eliminate the sales competition between competitors; and the RPM agreements between a supplier and its distributors always eliminate the intra-brand price competition among the distributors, etc.

B. Does the Word "Competition" under Article 13(2) Only Refer to "Inter-Brand Competition"?

After narrowing the meaning of "eliminate or restrict competition" to "have the effect of eliminating or restricting competition," the court at first instance further narrowed the meaning of competition to "inter-brand competition" only, holding that to determine whether there are such effects, a full consideration of factors such as the scope of relevant market, the market share of Yutai's fish feed, the specific competition degree of fish feed, and the impact of the agreement on the supply volume and price, etc., shall be carried out. The essence of this approach is to evaluate the competitive effects of RPM from the inter-brand competition dimension only, denying the enforcement agencies' approach of evaluating from the intra-brand price competition dimension.

We tend to think that there are two flaws of the above-mentioned opinions of the court at first instance.

1. It Limits the Meaning of "Market Competition" to "Competition between Manufacturers," Ignoring the Competition at the Distribution Phase

Innovation and competition at the distribution phase is an important part of the market competition. Antitrust guidelines of multiple countries strictly prohibit RPM since it always eliminates or restricts the price competition between distributors, and limits the ability of distributors to set prices independently.

In China, innovation and competition at the distribution phase also plays a very important role. For instance, e-commerce via the internet is a typical illustration of innovation at the distribution phase. As compared to traditional ways of distribution, the internet model bears less cost, has higher efficiency, and thus is able to offer the same goods at lower prices, and creates great surplus for the society.

In the meantime, competition at the distribution phase is very fierce, and the primary parameter for competition is price. For instance, there is fierce competition among different distributors/retailors, like Suning and Guomei, or Walmart and Carrefour, etc. In order to gain competitive advantage, these distributors/retailors lower their prices and organize shopping festivals such as "6.18" to attract consumers. Competition among distributors/retailors effectively promotes the innovation and lowers cost at the distribution phase, which in the end benefits the consumers.

If we ignore the price competition among distributors/retailors completely, and allow manufacturers to fix the resale price, all the distributors/retailors regardless of their efficiency, will have to sell at a uniformed price set by the manufacturer. As a result, those cost-effective

7 *The Background of the Enactment of the Anti-Monopoly Law (Draft),* the website of the National People's Congress, http://www.npc.gov.cn/npc/bmzz/caizheng/2006-07/07/content_1383750.htm.

8 Supra note 6.

distributors cannot gain competitive advantages via reducing cost and selling at a more competitive price. Moreover, efficient market entry may be hindered as well since potential entrants are not allowed to sell at lower prices to gain an advantage. In the end, the basic rule of market economy, "the survival of the fittest," will be destroyed as well.

2. It Confounds the Elements of Monopoly Agreements with the Anti-Competitive Degree of Monopoly Agreements

In fact, the factors listed by the court at first instance could only be relevant to the gravity of the actual anti-competitive effects, rather than the necessary elements to be considered in deciding whether competition is eliminated or restricted. Specifically, Article 49 of the AML prescribes that the extent of violation is one factor to be considered in deciding the amount of fine. Article 28 of the "Draft Guidelines on the Determination of Illegal Gains and Fines in Relation to Business Undertakings' Monopolistic Conduct" further specifies the factors in assessing the gravity of monopolistic conduct: the market share of the companies being investigated, the difficulty of market entry, the degree of concentration and competition in relevant markets, the market power of the counterparty, the territory scope of the illegal conduct, the extent of implementation of illegal conduct, the extent of price change of relevant products, and the loss suffered by consumers and other undertakings, etc.

Therefore, the first-instance judgment erroneously regards the above-listed factors as elements in deciding whether an agreement constitutes a monopoly agreement, confounding the elements of violation with the gravity of violation as well as obscuring the boundary between vertical monopoly agreement and abuse of market dominance.

V. ISSUE THREE: COMPETITIVE IMPACT ANALYSIS OF THE RPM CLAUSE INVOLVED

In the current case, the court at second instance explicitly upheld the "prohibited in principle, and exempted individually" enforcement approach. The court held that the law enforcement agencies do not need to specifically prove the effects of eliminating and restricting competition by RPM behaviors in individual cases. The court did not specifically analyze the competition effects of the clause involved.

We tend to opine that even if we refer back to the definition of Article 13(2) of the AML, the RPM clause involved still satisfies the definition of monopoly agreement. The RPM clauses are aimed at eliminating and restricting the price competition among distributors with anti-competitive purposes and thus constitute monopoly agreements. Even analyzing the specific competition effects, it is clear that RPM agreements have the effects of eliminating and restricting competition.

A. The RPM Clause Eliminates and Restricts the Price Competition of Yutai Fish Feed among All Distributors

In the current case, Yutai and all its distributors clearly agreed in the "Feed Products Sales Agreements" that: "Party B (the distributor) will keep the rebates plan of Party A (Yutai) in confidential, and the sales price of Party B shall follow the guidance price offered by Party A. Otherwise, Party A has the right to reduce rebates," i.e. all distributors must "obey" the guidance price offered by Yutai, and Yutai will penalized those distributors who do not obey by reducing their rebates. This clause in fact limits the rights of distributors to decide pricing by themselves. Once implemented effectively, all distributors will sell Yutai fish feed at a uniformed price, thus completely eliminating the price competition among distributors, distorting the normal functioning of the relevant product market and hindering the market from playing a decisive role in the allocation of resources.

B. The Fish Feed Industry in Hainan Province Has an Industry-Wide RPM Problem, which Further Eliminates and Restricts Market Competition

It is noteworthy that this case has some particularity in that the fish feed industry in Hainan Province has an industry-wide RPM problem. In the administrative sanction phase of this case, Hainan Price Bureau investigated eight fish feed enterprises in total and found that the turnover of these eight fish food manufacturers in 2014 accounted for 99.3 percent of the total turnover of Tilapia feed manufacturers in Hainan Province in 2014, which accounted for 99.2 percent in sales volume, basically covered most of the fish feed manufacturers in Hainan Province.

Practices have shown that vertical restrictions on industry will further aggravate the anti-competitive effects of the agreements and may even weaken the inter-brand competition. The "Anti-monopoly Guidelines for Auto Industry (Draft for Comments)" clearly states that:

when most and even all of the undertakings in relevant markets adopt similar agreements, in which various longitudinal restrictions form a network that fully covers the relevant markets, the restriction on inter-brand competition will be significantly weakened. The accumulative effects of similar longitudinal agreements may significantly restrict competition in relevant markets so that the relevant products and services are priced above the competition degree, which results in losses of benefits of the consumers in the end.

Back to this case, the industry-wide RPM behaviors in the fish feed industry in Hainan Province result in the vast majority of the prices of fish feed sold by the distributors being set by the manufacturers, which in fact severely eliminated and restricted the price competition among a large number of distributors, and also easily lead to the conspiracy among the fish feed manufacturers. Each of these fish feed manufacturers may ensure each other's prices are above a certain price level based on the RPM, thus, lose the incentive to compete in price, which will restrict the inter-brand competition. If not handled promptly, they will greatly increase the cost for the fish farmers and have a negative effect on consumer welfare.

VI. IMPACT OF THIS CASE

In our viewpoint, Judgment No. 1180 may also have some weaknesses. For instance, the judgment held that "eliminate or restrict competition" stipulated in Article 13(2) is not a necessary element of the monopoly agreements stipulated in Article 14. We tend to opine that this view may misunderstand the meaning of Article 14, because it means that the monopoly agreements stipulated in Article 14 by themselves "eliminate and restrict competition" rather than meaning that "eliminate or restrict competition" is not a necessary element. Also, the judgment held that the key difference between antitrust civil lawsuit and antitrust law enforcement lies in the fact that the former presupposes actual losses suffered by the plaintiff. Therefore, in the antitrust civil lawsuit, the effect of eliminating and restricting competition is an element for the RPM to constitute monopoly agreement. This view may confound the element of monopoly behavior with the factor in assessing damage claim.

Nevertheless, the weaknesses cannot overshadow the merits. As the first judicial review case of RPM administrative sanction decision in China, this case confronts controversy and shows the view of the court in a clear-cut manner. For the first time, in the form of judicial review, the court explicitly supported the correct approach "prohibited in principle, and exempted individually" in law application, which has great significance in clearing the long-lasting contradiction and confusion. It is noteworthy that shortly after the announcement of this case, on January 15, 2018, the Shanghai Price Bureau also announced two cases of administrative sanctions for RPM agreements. Given that, for a period of time from now on, RPM behaviors will remain the focus of antitrust enforcement. Enterprises should pay attention to antitrust compliance, especially the compliance of channel management, and should not leave the law application issue to chance.