

CPI's Asia Column Presents:

A Comparative Analysis of Antitrust Approaches to Resale Price Maintenance in China and the United States and Recommendations for China Going Forward

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Introduction

There is significant divergence between Chinese and U.S. approaches to antitrust analysis of vertical restraints, particularly for resale price maintenance (RPM). China, at least in administrative matters, generally applies a more formalistic approach with presumptions of illegality. In contrast, U.S. federal antitrust agencies and courts apply a full-blown effects-based analysis that requires a showing of harm to the competitive process and consumers. In addition, while the U.S. antitrust agencies and courts recognize that monopoly power is a necessary but not sufficient condition for RPM to harm consumers,² Chinese enforcers do not. Instead, Chinese enforcers have imposed liability for RPM absent a showing of monopoly power (or “dominance” as the concept is referred to in China).

There is also divergence within China itself as between administrative and private enforcement. Specifically, in administrative (or agency) enforcement, RPM is analyzed under a presumption of illegality (known as the “Prohibition + Exemption” approach), whereas courts have applied a rule of reason (or a full-blown effects-based) analysis for enforcement by private plaintiffs. Under the Prohibition + Exemption approach, China’s Anti-Monopoly Law (AML) is interpreted as strictly prohibiting RPM unless the investigated party can prove that one of the exemptions set forth in Article 15 apply. These exemptions include improved quality, reduced cost, or enhanced efficiencies when such benefits are passed-on to consumers. Under the rule of reason approach adopted by Chinese courts for private litigation, courts generally consider the following factors: (1) competitive conditions in the relevant market; (2) the market position (namely, shares) of the entity employing the RPM policy; (3) the purpose and/or motivation for RPM; and (4) the net effect of the RPM policy (i.e., a weighing of any pro- and anticompetitive effects).

In the remainder of this Article, we explain in further detail the approaches to RPM taken in China and the United States. We also recommend that China apply its rule of reason approach to both private and administrative enforcement matters. Such a move would bring administrative enforcement in line with the large body of empirical evidence indicating that vertical restraints, including RPM, are generally procompetitive or benign.

Indeed, as the former Director of the Bureau of Economics for the U.S. Federal Trade Commission (FTC), Francine Lafontaine, and her co-author, Professor Margaret Slade, explained when summarizing the body of economic evidence analyzing vertical restraints (including RPM), “it appears that when manufacturers choose to impose [vertical] restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision.”³

As explained further below, modern economics counsels against presuming competitive harm for vertical restraints. Indeed, economic theory, empirical evidence, and experience teach that vertical restraints (which include vertical territorial restrictions, RPM, exclusive dealing, loyalty discounts, tying, and other related business practices) rarely harm competition and often benefit consumers by reducing costs, aligning manufacturer and distributor incentives by decreasing free-riding, lowering price, increasing demand by inducing greater supply of promotional services, and/or creating a more efficient distribution channel.⁴

Importantly, with respect to measuring the welfare effects of minimum RPM in particular, courts and agencies need to assess both price and output effects. This is because, “[f]rom a consumer welfare perspective, measuring the impact of minimum RPM on price alone tells us little about the competitive effects of minimum RPM because both procompetitive and anticompetitive theories predict higher prices, all else equal. Analyzing the effect of minimum RPM on output, where the theories offer predictions in opposing directions, resolves this problem.”⁵

The Chinese and U.S. Approaches to RPM

Under Articles 14 and 15 of China's AML, RPM is strictly prohibited absent a showing by the investigated party that it meets one of the exemption criteria set forth in Article 15. Specifically, Article 14 provides that:

Undertakings are prohibited from concluding the following monopoly agreements with their trading counterparts:

- (1) on fixing the prices of commodities resold to a third party;
- (2) on restricting the lowest prices for commodities resold to a third party; and
- (3) other monopoly agreements confirmed as such by the authority for enforcement of the Anti-monopoly Law under the State Council.⁶

Article 15 provides that:

The provisions of Article 13 and 14 of this Law shall not be applicable to the agreements between undertakings which they can prove to be concluded for one of the following purposes:

- (1) improving technologies, or engaging in research and development of new products;
- (2) improving product quality, reducing cost, and enhancing efficiency, unifying specifications and standards of products, or implementing specialized division of production;
- (3) increasing the efficiency and competitiveness of small and medium-sized undertakings;
- (4) serving public interests in energy conservation, environmental protection and disaster relief;
- (5) mitigating sharp decrease in sales volumes or obvious overproduction caused by economic depression;
- (6) safeguarding legitimate interests in foreign trade and in economic cooperation with foreign counterparts; or
- (7) other purposes as prescribed by law or the State Council.

In the cases as specified in Subparagraphs (1) through (5) of the preceding paragraph, in order for the provisions of Articles 13 and 14 to be inapplicable, the undertakings shall, in addition, prove that the agreements reached will not substantially restrict competition in the relevant market and that they can enable the consumers to share the benefits derived therefrom.⁷

While Article 15 seems to require a balancing of any anti- and procompetitive effects (similar to the U.S. approach), based upon our review of the cases, balancing does not appear to be done in Chinese administrative matters.

Article 13 of the AML, while not explicitly mentioning RPM, states that, “[f]or the purposes of this Law [the AML], monopoly agreements include agreements, decisions and other concerted conducts designed to *eliminate or restrict competition*.”⁸ In other words, Article 13 could be interpreted—as some Chinese courts have done with respect to private enforcement—as requiring a showing of harm to the competitive process. For example, in China's 2013 landmark decision in *Rainbow vs. Johnson & Johnson*, despite finding that the RPM at issue was unlawful, the

Shanghai Higher People's Court held that proof of anticompetitive effects is required for vertical restraints, including RPM.⁹ The court reasoned that Article 13's definition of monopoly agreements as those that "are designed to eliminate or restrict competition" applies equally to the RPM agreements set forth in Article 14. The court reasoned that Article 50 of the AML—which states that, "[w]here the monopolistic conduct of an undertaking has caused losses to another person, it shall bear civil liabilities according to law"—provides the legal basis for imposing civil liability and damages.¹⁰

This rule of reason approach for private enforcement was recently endorsed by China's Guangdong High Court in its August 2018 decision in *Gree*.¹¹ In *Gree*, the Guangdong High Court dismissed an appeal in a private civil suit after assessing (1) the overall competition in the market, (2) the market position of the defendant, and (3) the purposes and effects of the price restrictions.¹² The court ultimately concluded that the relevant market was highly competitive and that the alleged RPM did not have any anticompetitive purposes or effects.¹³

In contrast, China's National Development and Reform Commission (NDRC) (now combined into the new State Administration for Market Regulation) has consistently applied the Prohibition + Exemption approach explained in the Introduction, above. This approach has been applied in a number of administrative decisions, including against Medtronic, Maotai, and Wuliangye, and is also reflected in the NDRC's Draft Guidelines for Antitrust Enforcement in the Automobile Industry.¹⁴

Recently, the Hainan High People's Court, in *Yutai v. Hainan Provincial Price Bureau*,¹⁵ was presented with the opportunity to resolve the conflicting approaches taken by Chinese courts and the NDRC, yet unfortunately only solidified the divergence.

Yutai was the first judicial review of the NDRC's approach to RPM (prior court decisions involving RPM were decided in the context of private, rather than administrative, proceedings). The court affirmed that two distinct enforcement standards exist in China. Like the court in *Johnson & Johnson*, the Hainan High People's Court reasoned that the basis of private civil lawsuits is Article 50 of the AML, which requires plaintiffs to provide evidence of actual damages for compensation.¹⁶ According to the court, such actual damages must arise from conduct that actually or potentially eliminates or restricts competition. However, the court went on to hold that government agencies are not required to prove anticompetitive effects, at least not with respect to RPM.¹⁷ The court did not, however, address the issue of why, as a matter of economics, RPM in administrative enforcement matters should be subject to a less rigorous (and more formalistic) standard. Given Chinese court determinations that RPM should be analyzed under a rule of reason approach as a matter of sound economics, it is troubling that this economically-sound approach is not required in administrative matters as well as in private enforcement.

In the United States, vertical restraints, including RPM, are analyzed under the rule of reason, a full-blown effects-based analysis.¹⁸ With respect to RPM in particular, the U.S. Supreme Court, in its 2007 decision in *Leegin Creative Leather Products v. PSKS, Inc.*, concluded that agreements in which a producer sets a minimum price at which retailers can sell a product are to be evaluated under the rule of reason.¹⁹ This decision (which was supported by the U.S. antitrust agencies) created consistency in the approaches applied to maximum and minimum RPM under U.S. federal antitrust law. In so holding, the Court relied upon the substantial body of economics literature, which the Court described as "replete with procompetitive justifications for a manufacturer's use of [RPM]," and as "cast[ing] doubt on the conclusion that the practice meets the criteria for a *per se* rule."²⁰

Following the Supreme Court’s decision in *Leegin*, the FTC considered a request by Nine West Footwear Corporation to release it from an earlier consent agreement that settled a case dealing with Nine West’s use of RPM.²¹ Relying on *Leegin*, the FTC granted Nine West’s petition on the basis that its use of RPM agreements was “not likely to harm consumers at this time.”²² In so holding, the FTC reviewed the following factors cited by the Court in *Leegin* as particularly relevant to the application of the rule of reason to RPM agreements:

- (1) “the number of competitors in the market that have adopted RPM agreements (The Court [explained] that interbrand competition would divert consumers to lower priced substitutes, thus limiting the likelihood that [RPM] could facilitate a manufacturing or retail cartel in markets in which only few competitors employ RPM);”²³
- (2) “whether the RPM originated with the manufacturer or the retailer (The Court observed that, because a manufacturer generally has incentives to promote efficient distribution that are aligned with the interests of consumers, harm to competition is more likely if RPM agreements are brought about as a result of retailer pressure rather than on the manufacturer’s own initiative.);”²⁴ and
- (3) “whether the manufacturer or retailer party to the RPM agreement has market power” (the Court explained, “If a retailer lacks market power, manufacturers likely can sell their goods through rival retailers . . . [a]nd if a manufacturer lacks market power, there is less likelihood it can use the practice to keep competitors away from distribution outlets”).²⁵

Economic Learnings

In a recent Comment from the Global Antitrust Institute, authors Koren W. Wong-Ervin, Judge Douglas H. Ginsburg, Joshua D. Wright, and Bruce H. Kobayashi set forth the economics of RPM.²⁶ In particular, the authors explain the following: “Economists nearly universally agree that while minimum RPM can generate anticompetitive outcomes in some instances, the empirical evidence indicates such agreements are more often than not procompetitive.”²⁷ Among the early empirical evidence on RPM is a 1983 report by Thomas Overstreet analyzing 68 FTC RPM cases from mid-1965-1982 and surveying the empirical studies on RPM available at the time.²⁸ Overstreet observed that an overwhelming number of the RPM cases brought and resolved by the FTC occurred in markets that were not conducive to either dealer or manufacturer collusion, and therefore concluded that RPM agreements generally are procompetitive.²⁹ Overstreet’s survey of the existing empirical work showed that although RPM can have both socially desirable and undesirable consequences, the studies did not support the conclusion that RPM agreements are more often than not anticompetitive.³⁰

In a 1991 study, Pauline Ippolito reviewed 203 litigated RPM cases reported from 1975 through 1982, concluding that they were generally inconsistent with theories of dealer or manufacturer collusion.³¹ In particular, Ippolito observed that allegations of horizontal price-fixing in these cases was exceedingly rare—appearing only 9.8 percent of the time in private cases and 13.1 percent of the time over all cases—even though that claim logically would have been included by plaintiffs if they had any evidence that the RPM arrangements in question reflected dealer or manufacturer collusion.³² Moreover, most of the cases offered facts suggesting procompetitive justifications for the use of RPM. This led Ippolito to conclude that “service- and sales-enhancing theories, taken together, appear to have greater potential to explain the [RPM] practices” than do collusion-based explanations.³³

Two more recent empirical surveys summarizing the empirical literature on vertical restraints offer additional evidence casting doubt on the proposition that minimum RPM is always or even usually anticompetitive. The first, authored by a group of U.S. Department of Justice (DOJ) and FTC economists, reviews 24 papers published between 1984 and 2005 providing empirical effects of vertical integration and vertical restraints.³⁴ The study offers a careful synthesis of the evidence. While only a handful of the selected studies involve only RPM rather than additional forms of vertical restraints, the authors conclude that while “[s]ome studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition.”³⁵

The second recent empirical survey, by Lafontaine and Slade, reviews 23 papers, including some in the study prepared by the DOJ and FTC economists.³⁶ Lafontaine and Slade reach a similar conclusion.

In an even more recent analysis of RPM, along with the related practices of exclusive territories and forward integration, former-FTC economist Dan O’Brien notes that three additions to the literature provide new evidence that such restraints mitigate double marginalization and promote retailer effort.³⁷ O’Brien goes on to conclude that, “[w]ith few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons,” and “supports a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases.”³⁸

Some, including Professor Jonathan Baker, have criticized reliance on some of these studies.³⁹ As Koren Wong-Ervin has previously explained:

Baker relies on a recent unpublished study in which the authors compared states that retain per se illegality for resale price maintenance (RPM) after the U.S. Supreme Court’s decision in *Leegin Creative Leather Products v. PSKS, Inc.* (in which the Court held that RPM is subject to the rule of reason) with states in which that practice would be reviewed under the rule of reason. The study purports to demonstrate that, in the years since *Leegin*, price increases for household consumer goods have been larger, and output growth smaller, in rule of reason states than in states retaining the per se rule against minimum RPM. According to Baker, “[t]his study suggests that the rule of reason did not deter anticompetitive uses of resale price maintenance that the per se rule deterred.” . . . [A]s Thomas Lambert and Michael Sykuta have explained, the “study is flawed” for a number of reasons, . . . includ[ing] its failure to account for the fact that anticompetitive theories of RPM predict both a reduction in output and an increase in price (only 1.6 percent of the product categories surveyed had both an increase in price and a decrease in quantity in states that shifted to the rule of reason) . . . [and] the fact that the study “systematically disregards information on transactions likely to reflect a pro-competitive use of minimum RPM.”⁴⁰

Thus, the study relied upon by Baker “cannot establish the authors’ conclusion that ‘the harm to consumers resulting from rule-of-reason treatment of minimum RPM seems to outweigh its benefits.’”⁴¹

Conclusion

Given the large body of empirical evidence indicating that vertical restraints, including RPM, are generally procompetitive or benign, we recommend that China revise its approach to administrative enforcement of RPM to adopt the same rule of reason approach set forth by Chinese courts for private enforcement. In conducting a rule of reason analysis of the welfare effects of minimum RPM, courts and agencies should assess both price and output effects given that both pro- and anticompetitive theories predict higher prices, all else equal.

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- ² OECD, RESALE PRICE MAINTENANCE 222 (Sept. 10, 2009), <http://www.oecd.org/daf/competition/43835526.pdf>.
- ³ Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, in HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008).
- ⁴ See, e.g., James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 642, 658 (2005) (surveying the empirical literature, concluding that although "[s]ome studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition," and "[i]n most of the empirical studies reviewed, vertical practices are found to have significant pro-competitive effects"); Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding*, 76 ANTITRUST L.J. 431 (2009); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005); Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, in THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 72–76 (2008) ("With few exceptions, the literature does not support the view that [vertical restraints] are used for anticompetitive reasons" and "[vertical restraints] are unlikely to be anti-competitive in most cases.").
- ⁵ Joshua D. Wright, *The Economics of Resale Price Maintenance & Implications for Competition Law and Policy*, Address Before the British Institute of International and Comparative Law 16 (2014), https://www.ftc.gov/system/files/documents/public_statements/302501/140409rpm.pdf.
- ⁶ Anti-monopoly Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), art. 14, [hereinafter AML] <http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045909.shtml>.
- ⁷ *Id.*, art. 15.
- ⁸ *Id.*, art. 13 (emphasis added).
- ⁹ *Rainbow vs. Johnson & Johnson* (Shanghai Higher People's Ct. Aug. 1, 2013), http://www.hshfy.sh.cn/shfy/gweb2017/flws_view.jsp?pa=adGFoPaOoMjAxMqOpu6a438PxyP0o1qop1tXX1rXaNjO6xSZ3c3hoPTUPdcisz (in Chinese).
- ¹⁰ AML, art. 50.
- ¹¹ *Gree* (Guangdong High Ct. Aug. 3, 2018), <http://www.gdcourts.gov.cn/web/content/41821-?lmdm=2001> (in Chinese).
- ¹² *Id.*
- ¹³ *Id.*
- ¹⁴ Nat'l Dev. & Reform Comm'n, *Anti-Monopoly Guide for the Automotive Industry* (Draft for Comment), (Mar. 23, 2016), http://www.ndrc.gov.cn/fzgggz/jgdyfld/fgld/201603/t20160323_795741.html.
- ¹⁵ *Yutai v. Hainan Provincial Price Bureau* (Hainan High People's Ct. Jan. 29, 2018), <http://wenshu.court.gov.cn/content/content?DocID=23889d51-88d8-4e87-aaa4-a85c01845f73&KeyWord=%E9%94%90%E9%82%A6> (in Chinese).
- ¹⁶ *Id.*
- ¹⁷ *Id.*
- ¹⁸ See, e.g., OECD, *supra* note 2, at 213.
- ¹⁹ *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007).
- ²⁰ *Id.* at 889-90.
- ²¹ See Press Release, Fed. Trade Comm'n, *FTC Modifies Order in Nine West Resale Price Maintenance Case* (May 6, 2008), <https://www.ftc.gov/news-events/press-releases/2008/05/ftc-modifies-order-nine-west-resale-price-maintenance-case>.
- ²² *Id.*
- ²³ OECD, *supra* note 2, at 220-21.
- ²⁴ *Id.* at 221.
- ²⁵ *Id.* (citing *Leegin*, 551 U.S. at 898).
- ²⁶ Comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University, on the Proposed Amendments to the Competition Law of the Socialist Republic of Vietnam (May 7, 2017),

https://gai.gmu.edu/wp-content/uploads/sites/27/2016/07/GAI-Comment_Vietnam-Competition-Law_5-7-17_FINAL.pdf.

- ²⁷ *Id.* at 7 (citing Joshua D. Wright, Comm’r, Fed. Trade Comm’n, The Economics of Resale Price Maintenance & Implications for Competition Law and Policy, Remarks Before the British Institute of International and Comparative Law 16 (Apr. 9, 2014), https://www.ftc.gov/system/files/documents/public_statements/302501/140409rpm.pdf (collecting studies)).
- ²⁸ THOMAS R. OVERSTREET, JR., BUREAU OF ECON., FED. TRADE COMM’N, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (Nov. 1983) <https://www.ftc.gov/sites/default/files/documents/reports/resale-price-maintenance-economic-theories-and-empirical-evidence/233105.pdf>.
- ²⁹ *Id.* at 11.
- ³⁰ *Id.* at 163.
- ³¹ Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991).
- ³² *Id.* at 281.
- ³³ *Id.* at 291-92.
- ³⁴ Cooper et al., *supra* note 4.
- ³⁵ *Id.*
- ³⁶ Lafontaine & Slade, *supra* note 3.
- ³⁷ O’Brien, *supra* note 4.
- ³⁸ *Id.* at 76.
- ³⁹ See Jonathan B. Baker, *Taking the Error out of “Error Cost” Analysis: What’s Wrong with Antitrust’s Right*, 80 ANTITRUST L. J. 1, 20 (2015) (internal citations omitted).
- ⁴⁰ Koren Wong-Ervin, *Antitrust Analysis of Vertical Mergers: Recent Developments and Economic Teachings*, ANTITRUST SOURCE, forthcoming 2019, at 5-6, <https://ssrn.com/abstract=3273344> (citing Alexander MacKay & David Aron Smith, *The Empirical Effects of Minimum Resale Price Maintenance on Prices and Output* (Kilts Booth Mkt. Series, Paper No. 2-006, June 16, 2014), <https://ssrn.com/abstract=2513533>); Thomas A. Lambert & Michael Sykuta, *Why the New Evidence on Minimum Resale Price Maintenance Does not Justify a Per Se or “Quick Look” Approach*, CPI ANTITRUST CHRON., Nov. 2013, at 7-8, <https://www.competitionpolicyinternational.com/assets/Uploads/LambertSykutaNOV-131.pdf>.
- ⁴¹ Lambert & Sykuta, *supra* note 43, at 8.