CPI's Asia Column Presents:

Exclusive Dealing in China: Overview and Outlook from an Antitrust Perspective

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Common in the business world, exclusive dealing refers to arrangements whereby a business operator requires its transaction counterparties to deal exclusively with it or other designated business operators or, alternatively, not to deal with specific business operators. Large and small business operators alike adopt these arrangements for a variety of reasons, and most are benign or even pro-competitive. Exclusive dealing manifests itself in various forms, for example as an exclusive supply arrangement benefiting a buyer or platform operator or as an exclusive purchasing arrangement benefiting the supplier.

In China, exclusive dealing is a particularly important antitrust concept:

- The two leading authoritative cases on exclusive dealing, *Tetra Pak*[1] and *Eastman*,[2] are among the most complex and widely discussed antitrust cases in China, particularly due to their in-depth economic analyses.
- Most public enforcement cases are in the public utility industry and concern exclusive dealing practices; this industry arguably faces the most antitrust enforcement pressure in China.
- Exclusive dealing arrangements are prevalent in internet-based industries and are broadly debated among stakeholders, among which the "choose one of two" policy adopted by certain internet platforms is perhaps the most controversial.

This article provides an overview of exclusive dealing-related cases in China, analyzes the application of the relevant provisions of the Chinese Anti-Monopoly Law, and shares our observations on the relevant market and enforcement trends.

I. Overview of Exclusive Dealing Enforcement in China

Our research of publicly available information to date identified 15 public enforcement cases and 23 private enforcement cases in relation to exclusive dealing arrangements under the Anti-Monopoly Law. Our analysis suggests that public enforcement does not focus on those industries in which disputes most often arise among private parties.

Table 1 –Public Enforcement Cases by Industry

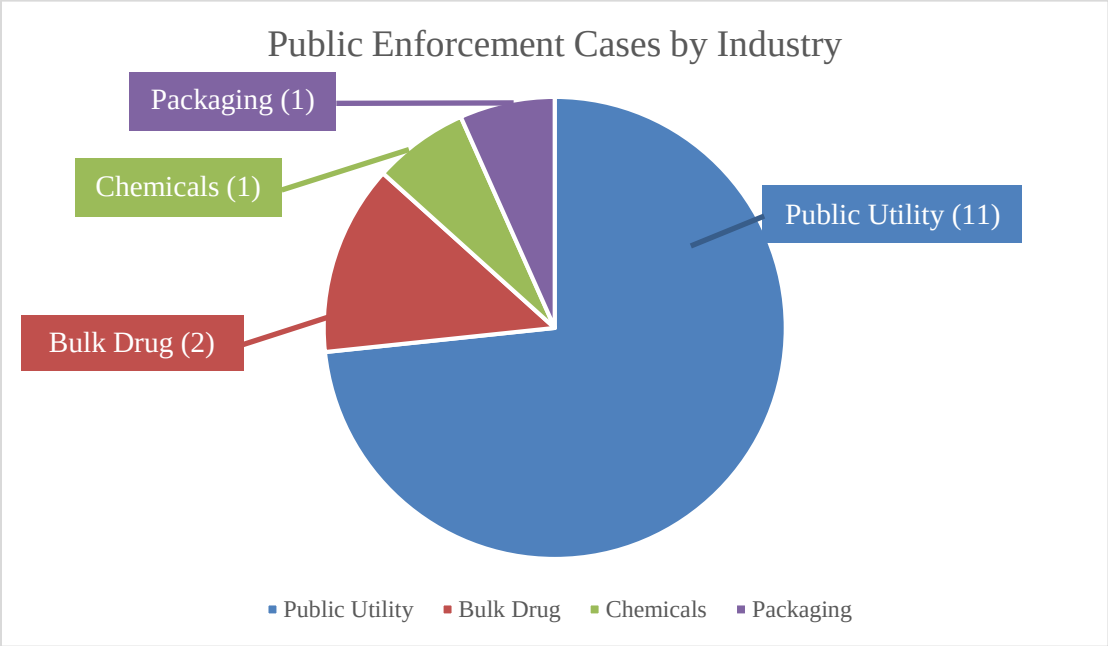
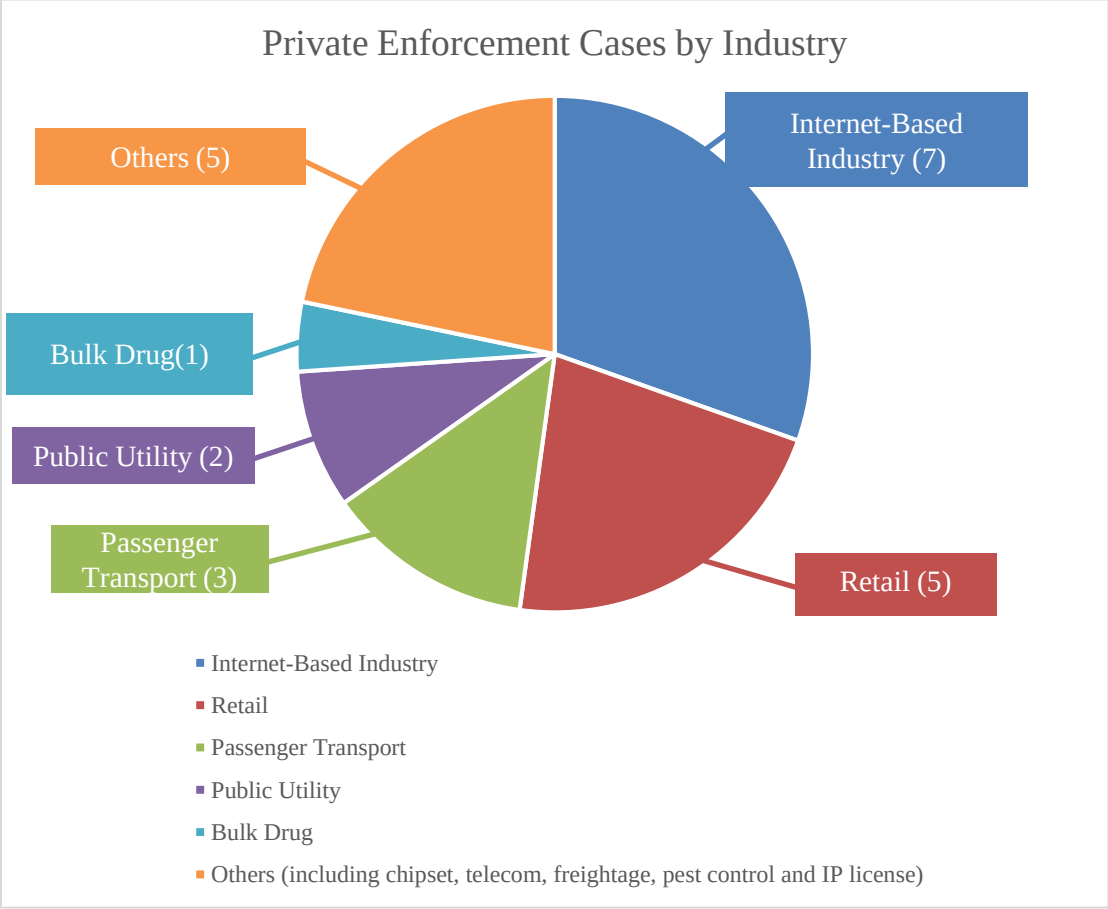


Table 2 –Private Enforcement Cases by Industry



Notably, public enforcement cases are concentrated in the public utility and bulk drug industries, where it is relatively easy for the Chinese competition authorities to determine the existence of a dominant market position. Further, it is also easier to demonstrate harm to competition in these industries given that the dominant players often take close to 100 percent market share. In this respect, *Tetra Pak* and *Eastman*, the only two public enforcement cases outside these industries, have helped the Chinese competition authorities gain attention from the worldwide antitrust community, due to the depth of analysis and nuances involved in adjudicating these cases. For these reasons, *Tetra Pak* and *Eastman* continue to be widely discussed due to their value in illustrating positions the Chinese competition authorities may take in future cases.

By comparison, private enforcement cases by way of civil litigation are more dispersed in terms of industry distribution. The largest number of private enforcement cases which cite Article 17 (4) of the Anti-Monopoly Law appear in internet-based industries, 7 (or 30.4 percent of the cases), which echoes the level of media attention these cases receive. In contrast with public enforcement cases, only two private enforcement cases were found in the public utility industry and one case in the bulk drug industry. Based on our experience, possible explanations for this could be that: (a) monopolies in these industries are so entrenched that aggrieved parties dare not challenge them in court for fear of immediate retaliation; and (b) public enforcement in these industries is relatively more effective, allowing stakeholders to seek relief by lodging complaints with the competition authorities and obviating the need to file private lawsuits. Excluding three ongoing cases, of the other 20 private enforcement cases we found, the plaintiffs withdrew 10 percent of the cases (2 cases), lost in 75 percent of the cases (15 cases), and won in only 15 percent of the cases (3 cases, concerning the passenger transport industry, public utility industry, and bulk drug industry). The results of these cases reflect the extreme difficulty for plaintiffs to prevail in court in exclusive dealing cases in China.

Another notable finding is that all these exclusive dealing cases cited the Anti-Monopoly Law at Article 17 (abuse of dominance) while none cited Article 14 (monopoly agreements), the rationale behind which we explore in the following section.

There exists a large number of cases concerning exclusive dealing arrangements in which the Anti-Monopoly Law is not invoked. Consider the food delivery platform market: according to PaRR, among 22 cases in which local competition authorities imposed penalties against food delivery platforms between 2015 and 2019, seven (32 percent) were imposed under Article 35 of the E-commerce Law; six (27 percent) cited local anti-unfair competition regulations; and six (27 percent) were based on the Anti-Unfair Competition Law, among which five cited Article 12(2) of the amended Anti-Unfair Competition Law - an internet-related provision.[3] In our view, local authorities may prefer to rely upon laws and regulations other than the Anti-Monopoly Law (especially in cases concerning “new economy” industries), because these provisions do not require the determination of dominant market position and/or rigid competition analysis and because these provisions also tend to be less punitive and thus invite less resistance from alleged violators.

II. Provisions Applicable under the Anti-Monopoly Law

In theory, both Article 14 and Article 17 of the Anti-Monopoly Law could apply to exclusive dealing arrangements. However, the Chinese competition authorities have yet to publicly invoke Article 14 in an exclusive dealing case. This may be due in part because local competition authorities handle the majority of cases, while authority to invoke Article 14 against non-price related vertical restraints resides only with the national competition authority, the State Administration for Market Regulation ("SAMR").[4] In addition, application of Article 14 to exclusive dealing arrangements is also less discussed in academic circles. For example, Professor Wang Xiaoye, in a recent influential article on the "choose one of two" exclusive dealing arrangement does not make mention of the application of Article 14.[5]

Nevertheless, because the possibility exists for SAMR to apply Article 14, it remains useful to understand how SAMR could analyze exclusive dealing arrangements under this article. In this regard, Article 13 of the *Interim Provisions on Prohibition of Monopoly Agreements* provides the overarching factors which SAMR would consider in assessing vertical restraints other than resale price maintenance, which are: (1) the facts behind reaching and implementing the agreements; (2) the state of competition in the relevant market; (3) the undertakings' market share in the relevant market and level of control over the relevant market; (4) the impact of the agreements on aspects of the relevant products such as price, quantity, quality, etc.; (5) the impact of the agreements on market entry and technological improvements, etc.; (6) the impact of the agreements on consumers and other undertakings; and (7) other relevant factors. Among these factors, items 4 to 6 cover the impact of the conduct. The assessment under Article 13 naturally involves a balancing act as it does not specify whether the impact is pro- or anti-competitive; a defendant could therefore argue over the effect of its agreement on the market without the need to prove that its conduct is based on a legitimate reason.

In contrast, Article 17 of the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions* (*《禁止滥用市场支配地位行为暂行规定》*), promulgated by SAMR and dated June 26, 2019, appears more stringent in regulating exclusive dealing, as such conduct by a market dominant undertaking is prohibited unless it can demonstrate a "legitimate reason." The interim provisions provide examples of legitimate reasons for exclusive dealing which relate more to the legitimacy of the motives behind the conduct rather than the overall harm to competition the conduct may cause, such as the necessity to satisfy product safety requirements, to protect intellectual property rights, and to protect transaction-specific investments. This observation is echoed in official guidance on the provision.[6] However, Article 20 of the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions* runs contrary to this notion and opens the door for objective analysis of the conduct's effect on competition by providing that consideration should be given to the impact on economic efficiency and development when evaluating whether legitimate reasons exist. This issue is important because dominant firms often implement exclusive dealing arrangements solely for the purpose of fiercely competing for customers with their competitors, which acts to intensify competition in the relevant market and therefore should not be condemned, but rather encouraged.

In practice, the Chinese competition authorities have always included in their penalty decisions a section discussing anti-competitive effect. It is unclear, however, whether such a section is necessary for a decision to withstand a challenge in administrative litigation. In *Yutai*

v. Hainan Price Bureau,[7] the Supreme People's Court held that the antitrust enforcement authority needed not prove anti-competitive effect in its decision in a resale price maintenance case and, rather, that the business operator bore the burden of proving its conduct was exempted under Article 15 of the Anti-Monopoly Law. Courts could adopt a similar position where an undertaking challenges an administrative penalty decision rendered against its alleged abuse of market dominance. It is thus conceivable for the Chinese competition authorities to increase enforcement of exclusive dealing arrangements while conserving administrative resources by limiting economic analysis of the anti-competitive effect in each case and simply evaluating whether the undertaking's reasons for the arrangement are indeed legitimate.

III. Market Trends

In recent years, smaller companies have learnt to use the Anti-Monopoly Law as a cudgel when faced with exclusive dealing arrangements or when such arrangements hinder market entry or expansion. For example, Tmall has faced lawsuits brought by both merchants on its platform and competing platforms for its alleged "choose one of two" platform exclusivity behavior; Starbucks was sued by Luckin Coffee for its exclusivity terms with shopping malls and vendors;[8] and food delivery platforms have received complaints from restaurant associations for mandating exclusive agreements. These litigations and complaints, however, have resulted in only a few publicly disclosed judgments or administrative decisions citing the Anti-Monopoly Law. That said, most claimants have benefited from their bold actions, either by winning better terms or by drawing public attention.

At the same time, larger companies have developed strategies to reduce legal risk in relation to exclusive dealing arrangements. We have observed companies taking the following protective measures:

a) replacing naked exclusive dealing arrangements with more complex arrangements involving the application of different commercial terms to exclusive and non-exclusive business relationships;

b) replacing naked exclusive dealing arrangements with softer-version arrangements that fix a certain percentage of the demand/supply; and

c) incorporating cooperation arrangements into the relevant agreements and sometimes even explaining in detail the relationships between the cooperation arrangements and the exclusive arrangements.

Such protective measures could indeed make it more difficult to apply the relevant antitrust provisions. Consider, for example, Article 17 of the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions*, item (a) could still be deemed violative as an "indirect restriction," but it is less clear what level of indirect restriction should be penalized; item (b) calls into question whether Article 17 could apply, given that the restricted party can still deal with third parties;[9] and item (c) provides within the agreement potentially legitimate reasons for the arrangement.

IV. Enforcement Trends

We expect enforcement to continue in relation to exclusive dealing conduct in the public utility and the bulk drug industries. Recent examples of enforcement actions in 2020 include *Calcium Gluconate Injection*,[10] in which SAMR punished Kanghui's exclusive dealing arrangements with upstream manufacturers; and in *Shanxi Jianke*[11] and *Shanxi Xinzhou Gas*,[12] in which the Shanxi competition authority criticized the operators' exclusive dealing agreements with their downstream real estate enterprise customers.

Outside of these two industries, we believe the Shanghai competition authority set a good example for other local competition authorities in *Eastman* in 2019, in which the authority demonstrated in its penalty decision a high level of sophistication in its analysis. However, this case again illustrates the challenges that competition authorities face in handling such cases, which could deter less experienced local competition authorities. In an article published in the China Market Regulation News,[13] two regulatory officials revealed that the case team's assessment of legitimate reasons focused on balancing positive efficiency and negative effects on competition, which could provide some relief to the market.

As for internet-based industries, the government has long followed a "tolerant and prudent" policy, presumably to encourage the development of such nascent industries.[14] As a result, the competition authorities have rarely invoked the Anti-Monopoly Law against internet platforms; rather, they have preferred to resolve disputes through various forms of mediation, e.g. warnings,[15] summonses for commitments,[16] or government-mediated settlements.[17] That said, internet-based industries are quite active and also generate probably the most complaints from business operators as well as consumers. Such complaints are typically more visible due to widespread media coverage. Therefore, we have seen SAMR gradually move toward a more proactive approach. At a seminar in November 2019, SAMR made clear its views that exclusive dealing conduct is capable of harming platforms, vendors, and consumers and violating the basic idea of an open and shared internet, and warned internet platforms that it would maintain close scrutiny of their behaviors, open investigations when appropriate, and that platforms should expect severe punishment where such behaviors are deemed abusive.[18] In July 2020, SAMR further caused 20 major internet platforms to sign a "commitment letter," where they committed "not to force venders on their platforms into 'exclusive partnerships' or 'exclusive licensing', and not to impose unreasonable restrictions or conditions on vendors on their platforms in respect of choosing platforms."[19] These strong moves by SAMR could signal future enforcement actions, as similar patterns have been observed in the bulk drug industry and the memory chip industry, among others.

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[1] See administrative sanction decision against Eastman issued by Shanghai Market Regulation Administration on April 16, 2019, Hu Shi Jian An Chu Zi [2019] No. 000201710047 (沪市监案处字[2019] 第000201710047号).

[2] See administrative penalty decision against Tetra Pak issued by the former State Administration for Industry and Commerce on November 9, 2016, Gong Shang Jing Zheng An Zi [2016] No. 1 (工商竞争案字[2016]1号).

[3] PaRR (Policy and Regulatory Report), "China's enforcers apply varying laws in penalty decisions against food delivery platforms for exclusivity," https://app.parr-global.com/intelligence/view/prime-3054502, last visit on August 3, 2020.

[4] See Article 13 of the *Interim Provisions on Prohibition of Monopoly Agreements* (《*禁止垄断协议暂行规定*》) promulgated by SAMR and dated June 26, 2019.

[5] See *The Legal Regulation of Either-or Choice of Online Platforms in E-Commerce* (《论电商平台"二选一"行为的法律规制》), Wang Xiaoye, Modern Law Science, Vol. 42 No. 3, May, 2020, P151.

[6] "If the undertaking's restrictive dealing conduct is not for the purposes of excluding or restricting competition, but for legitimate business considerations, such conduct cannot be deemed as an abuse of dominant market position." See *Knowledge Book of the Anti-Monopoly Law of the People's Republic of China* (《<中华人民共和国反垄断法>知识读本》), the Anti-Monopoly Commission of the State Council, P130.

[7] *Yutai v. Hainan Price Bureau,* (2018) Zui Gao Fa Xing Shen No. 4675 ((2018) 最高法行申4675号), (Supreme People's Ct, Dec. 18, 2018).

[8] "Luckin Coffee released an open letter saying it will sue Starbucks for suspected monopoly conducts; Starbucks responded" (瑞幸咖啡发布公开信称将起诉星巴克涉嫌垄断 星巴克回应), http://www.ce.cn/xwzx/gnsz/gdxw/201805/15/t20180515_29141827.shtml, last visit on August 2, 2020.

[9] The Eastman case could be a good reference in this regard, in which the exclusive agreements at issue fixed about 80 percent of consumer demand.

[10] See administrative sanction decision against Kanghui issued by the SAMR on April 9, 2020, Guo Shi Jian Chu [2018] No. 8 (国市监处[2020]8号).

[11] See administrative sanction decision against Shanxi Jianke issued by the Shanxi Market Regulation Administration on July 2, 2020, Jin Shi Jian Jia Jian Fa Zi [2020] No. 13 (晋市监价监罚字[2020]13号).

[12] See administrative sanction decision against Shanxi Xinzhou Gas issued by the Shanxi Market Regulation Administration on July 13, 2020, Jin Shi Jian Jia Jian Fa Zi [2020] No. 14 (晋市监价监罚字[2020]14号).

[13] "On the investigation and handing of cases of abuse of market dominance with the Eastman case as an example" (说案丨以伊士曼垄断案为例谈滥用市场支配地位案的查办), http://www.cqn.com.cn/ms/content/2019-07/09/content_7296200.htm, last visit on August 2, 2020.

[14] "SAMR: Tolerant and prudent regulation over internet platform economy" (国家市场监管总局：对互联网平台经济坚持包容审慎监管), http://www.scio.gov.cn/32344/32345/39620/41286/zy41290/document/1661587/1661587.htm, last visit on July 31, 2020.

[15] "The Beijing AIC warned Qihoo 360 for bundling" (北京工商行政告诫360软件 流氓捆绑模式遭叫停), http://www.dzwww.com/caijing/cjsl/201301/t20130125_7951879.htm, last visit on July 31, 2020.

[16] "Forcing vendors to 'choose one of two'… Xinjiang AMR corrected the operation of e-commerce platforms" (强迫商家"二选一"、刷单炒信、虚假折扣……自治区市场监管局规范电商平台经营行为), http://news.ts.cn/system/2020/04/27/036235603.shtml, last visit on July 31, 2020.

[17] "Cainiao and SF Express reached settlement"(菜鸟网络与顺丰达成和解), https://m.huanqiu.com/article/9CaKrnK3RAU, last visit on July 31, 2020.

[18] *Id.*

[19] "20 internet platforms jointly committed: maintain a good market order and promote the healthy development of the industry" (20家互联网平台企业共同承诺：维护良好市场秩序促进行业健康发展), https://baijiahao.baidu.com/s?id=1672482566083212544&wfr=spider&for=pc, last visit on July 31, 2020.