BUILDING A COHERENT LEGAL FRAMEWORK FOR VERTICAL PRICE RESTRICTIONS IN CHINA

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On August 1, 2022, a reform of China's Anti-Monopoly Law ("AML") came into effect. The changes affect, inter alia, the regulatory framework for vertical price fixing and minimum resale price maintenance ("RPM"). The reform largely follows the Supreme People's Court in *Yutai*, attempting to reconcile the positions of the antitrust agencies and the judiciary. This article explores the application of the AML to vertical price fixing and minimum RPM over the years, and the implications of the adjustments made to China's basic competition legislation. The article covers the original drafting of the AML, the judicial and administrative positions, the landmark *Yutai* judgment, the AML reform and recent administrative decisions. In doing so, the article attempts to shed light on the road ahead for the legality of vertical price restrictions in China.

I. INTRODUCTION

In the 14 years that have passed since the entry into force of the Anti-Monopoly Law ("AML"),[2] China's first competition legislation, few topics have been as contentious as the treatment of vertical price restraints. The "prohibition in principle plus exemption" approach[3] established in the original version of the AML for both vertical price fixing and minimum resale price maintenance ("RPM") raised doubts as to whether anticompetitive effects had to be demonstrated to sustain a breach of the law. This in turn led to tensions between the administrative and judicial interpretations of the rules. For the former, effects would not be necessary for a violation to occur, while the latter insisted on linking illegality to actual harm.

On August 1, 2022, a reform of the AML came into effect that modifies, or at least clarifies, the rules affecting vertical price fixing and minimum RPM in China.[4] The reform largely follows the Supreme People's Court Yutai judgment,[5] which attempted to reconcile the positions of the antitrust agencies and the judiciary. This article explores the application of the AML to vertical price fixing and minimum RPM over the years, and the implications of the recent changes made to China's basic competition legislation. It covers the original drafting of the AML, the judicial and administrative positions, the landmark Yutai case, and the post-*Yutai* developments (focusing on both the AML reform and recent administrative decisions). In doing so, the article attempts to shed light on the road ahead for the legality of vertical price restrictions in China.

II. THE AML'S INITIAL POSITION ON VERTICAL PRICE RESTRAINTS

Article 14 of the AML declares monopoly agreements illegal when they fix "the prices of commodities resold to a third party" (vertical price fixing) or they restrict "the lowest prices for commodities resold to a third party" (minimum RPM).[6] Article 15 includes a list of exemptions, applicable when the arrangements pursue at least one of the following aims: "improving technologies, or engaging in research and development of new products"; "improving product quality, reducing cost, and enhancing efficiency, unifying specifications and standards of products, or implementing specialized division of production"; "increasing the efficiency and competitiveness of small and medium-sized undertakings"; "serving public interests in energy conservation, environmental protection and disaster relief"; "mitigating sharp decrease in sales volume or obvious overproduction caused by economic depression"; "safeguarding legitimate interests in foreign trade and in economic cooperation with foreign counterparts"; or "other purposes as prescribed by law or the State Council."[7] For the first five exemptions to apply, the parties must prove that no substantial restrictions of competition will ensue and that consumers will participate in the benefits of the agreement.[8]

The wording of Article 14 in the initial version of the AML appeared to suggest that the ban on monopoly agreements vertically fixing prices or imposing minimum RPM would be categorical. However, Article 13 of the AML states that for monopoly agreements to be contrary to the law they need to be "designed to eliminate or restrict competition."[9] This clarification raised doubts as to whether enforcers and plaintiffs relying on Article 14 would need to demonstrate that the monopoly agreement under consideration was devised with the purposes described in Article 13, and if effects would be necessary for the restraints to be unlawful. It led to inconsistencies in the interpretation of the Article 14 prohibitions that persisted until the Supreme People's Court had the chance to rule on the matter, as discussed in the next section of this article.

2 Anti-Monopoly Law of the People's Republic of China ("AML") (中國人民共和國反壟斷法) promulgated by the Standing Committee of the National People's Congress (effective Aug. 1, 2008) http://www.npc.gov.cn/zgrdw/englishnpc/Law/2009-02/20/content_1471587.htm.

3 *Interview with Wu Zhenguo, Director General, Anti-Monopoly Bureau of the State Administration for Market Regulation (SAMR), People's Republic of China*, ANTITRUST MAGAZINE 18 (June 21, 2021) https://www.samr.gov.cn/xw/zj/202107/P020210707589294998827.pdf.

4 Decision of the Standing Committee of the National People's Congress on Amending the Anti-Monopoly Law of the People's Republic of China (June 24, 2022), http://www.npc.gov.cn/npc/c30834/202206/e42c256faf7049449cdfaabf374a3595.shtml.

5 *Hainan Yutai Technology Feed Co., Ltd. v. Hainan Price Bureau*, Supreme People's Court, case No. (2018) Zui Gao Fa Xing Shen No. 4675 (hereinafter *Yutai*).

6 AML, *supra* note 2, Art. 14.

7 *Ibid*, Art. 15.

8 *Ibid.*

9 *Ibid*, Art. 13.

III. JUDICIAL AND ADMINISTRATIVE INTERPRETATIONS IN THE FIRST DECADE OF ENFORCEMENT OF THE AML

The framework for the analysis of vertical price restraints developed by the courts is not dissimilar to that employed by enforcers, and yet at times they have reached largely divergent conclusions. The first time the judiciary comprehensively addressed the application of the AML to minimum RPM was in 2013, in the *Johnson & Johnson* case.[10] Overturning the judgment of the Shanghai Intermediate People's Court in the first instance,[11] the Shanghai Higher People's Court awarded Rainbow, the plaintiff, damages of RMB 530,000.[12] The appeal focused on the effects of the minimum RPM imposed by Johnson & Johnson. The company was found to possess significant market power, with a market share in excess of 20 percent.[13] The court saw evident harm, including the reduction of both of intrabrand and interbrand competition, the exclusion of efficient dealers from the system, the limitation of the dealers' autonomy to set resale prices, and negative consequences for consumers. According to the court, there were no obvious countervailing efficiencies, and there would be little need to protect distributors from free riders since buyers were widely familiar with the products.

The plaintiff may have won in *Johnson & Johnson*, but the court nonetheless acknowledged potential valid justifications for minimum RPM, such as the need to protect product quality or market entry. In fact, the analytical framework laid down by the Shanghai Higher People's Court has led other courts to dismiss similar cases on the basis of lack of actual harm. In *Gree*,[14] the plaintiff distributor alleged that their contract termination was a form of punishment for not adhering to the minimum prices imposed by the seller. The court found no anticompetitive object or effect, and no market power. Moreover, since distributors could compete on aspects other than prices, competition would not have been completely eliminated. On the basis of these findings, the court found in favor of the defendant, and saw no breach of Article 14 of the AML.

China's anti-monopoly enforcement authorities ("AMEAs") have been somewhat quicker to find vertical price fixing and minimum RPM illegal. In the 2013 decision against *Maotai*,[15] the Guizhou Price Bureau imposed a fine of RMB 247 million on the state-owned liquor producer after establishing that it had fixed resale prices for third party distributors, which restricted competition in the market in the detriment of consumer welfare. There was reference to the market power of the company, but the relevant market was not defined.[16] On the same day, the Sichuan Development and Reform Commission slapped a fine of RMB 2020 million on *Wuliangye*,[17] another state-owned liquor company, for engaging in minimum RPM. It monitored its distributors' prices and punished those not respecting its requirements. The enforcer focused on Wuliangye's "strong market position,"[18] and found restrictions of both intrabrand and interbrand competition, and consumer harm.[19] It is worth noting that the combined market share of Maotai and Wuliangye in the market for high-priced white spirits was around 75 percent.[20] The fines amounted to 1 percent of the companies' 2012 sales revenues.[21]

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10 Margaret Wang, *China's Current Approach to Vertical Agreements Under the Anti-Monopoly Law*, COMPETITION POLICY INTERNATIONAL: ASIA ANTITRUST COLUMN 1, 5-7 (2012), https://www.competitionpolicyinternational.com/assets/Free/cpiasiawang.pdf.

11 *Ruibang Yonghe Technology & Trade Co., Ltd. (Rainbow Medical Equipment and Supplies Co.) v. Johnson & Johnson Medical (China) Ltd.*, Shanghai No. 1 Intermediate People's Court, (May 18,2012).

12 *Ruibang Yonghe Technology & Trade Co, Ltd. (Rainbow Medical Equipment and Supplies Co.) v. Johnson & Johnson Medical (China) Ltd.*, Shanghai Higher People's Court No. 63 (Aug. 1, 2013).

13 Qingxiu Bu, *Can Suppliers Fix Final Prices? The Contribution of China to the Debate on Resale Price Maintenance* 6 JOURNAL OF EUROPEAN COMPETITION LAW & PRACTICE 110, 116 (2015).

14 *Dongguan Hengli Guochang Electrical Appliance Store v. Dongguan Shengshi Xinxing Gree Trading Co., Ltd. and Dongguan Heshi Electrical Appliance Co., Ltd.*, (2015) Yue Zhi Fa Shang Min Chu Zi No. 33 (2015) (粤知法商民初字第33号)

15 Guizhou Price Bureau, *Kweichow Maotai* [2013] No. 1, (Feb. 22, 2013). See also *The Guizhou Price Bureau announces a fine of RMB 247 million on Maotai*, China News (Feb. 22, 2013) http://www.chinanews.com/cj/2013/02-22/4588648.shtml (in Chinese).

16 See Xiaoye Wang and Adrian Emch, Five Years of Implementation of China's Anti-Monopoly Law—Achievements and Challenges' 1 JOURNAL OF ANTITRUST ENFORCEMENT 247 (2013).

17 Sichuan Development and Reform Commission, *Fine of RMB 202 million imposed on Wuliangye for price monopoly* (Feb.22, 2013).

18 *Ibid.*

19 *Ibid.*

20 Jingmen Cai, *Public Antitrust Enforcement of Resale Price Maintenance in China: A Crusade or Discrimination?*, 42 BROOKLYN JOURNAL OF INTERNATIONAL LAW 1, 14 (2016).

21 *Ibid.* at 17.

Subsequent administrative cases were decided along similar lines. In the *Infant Formula* case of August 2013,[22] multinational formula manufacturers were fined a total of RMB 668 million vertical price fixing and minimum RPM. The National Development and Reform Commission (NDRC) found the practices harmed both competition and consumers.[23] That same year, eyeglasses producers were fined for implementing minimum RPM,[24] but only those with large market shares were investigated and punished. Between 2014 and 2015, a string of penalties was imposed on various car manufacturers for minimum RPM arrangements.[25] In 2016, US medical device manufacturer Medtronic was similarly punished for its agreements with various distributors to restrict prices.[26] There is analysis of effects, referring to harm to competition, consumer harm, market power, high entry barriers. Aggravated by territorial restrictions. Set resale prices, fixed profit margins.[27] Overall, the pre-2018 enforcement decisions appear to suggest that while the agencies examined the context and the consequences of the restrictions, effects would not be required for Article 14 to be breached.

IV. THE SUPREME PEOPLE'S COURT TAKE: YUTAI (2018)

In 2018, the Supreme People's Court had the chance to rule on the compatibility of vertical price restrictions with the AML in *Yutai*.[28] The case arose from an appeal to a penalty imposed in 2015 on the Chinese fish food producer by the Hainan Price Bureau. According to Yutai's agreements with its distributors, the latter would have to abide by the former's pricing guidance, and risked losing beneficial rebates if they did not comply. In the first instance, the court found in favor of Yutai, since it was a small company with little market power, the price restrictions did not have anticompetitive effects.[29] The Hainan Price Bureau appealed, and won both in the Hainan Higher People's Court[30] and in the Supreme People's Court.[31]

The litigation provided a unique opportunity for the Supreme People's Court. Not only did it touch upon an unsettled matter; it also stemmed from a challenge to an administrative penalty. Appeals of AMEAs' decisions remain "a rarity" in Chinese antitrust enforcement.[32] The Supreme People's Court clarified that, as per Article 13 of the AML, monopoly agreements must aim to eliminate or restrict competition. However, this does not equate to requiring an anticompetitive effect. As a consequence, a monopoly agreement may exist irrespective of whether it has caused actual harm. At the same time, the court attempted to reconcile the position of the courts and the AMEAs by explaining that civil liability does require actual damages, and therefore courts are correct to require plaintiffs to prove how the conduct affected them in the context of civil litigation. Yet when it comes to administrative enforcement, it is sufficient to prove the existence of vertical price fixing or minimum RPM to find that a monopoly agreement contrary to Article 14 exists. Effects need not be shown by the antitrust agencies, but undertakings may provide evidence demonstrating that their conduct either did not bear negative effects on competition or meets the requirements for exemption laid down in Article 15 of the AML.[33] The existence of an Article 14 price restraint thus creates a rebuttable presumption of harm, and the burden of proof will be on the companies wishing to refute the illegality of the practice.

22 NDRC, *RMB 668.73 million penalty on formula producers for restricting competition* (合生元等乳粉生产企业违反《反垄断法》限制竞争行为共被处罚6.6873亿元) (Aug. 7, 2013).

23 Shan Jiang and D. Daniel Sokol, 'Resale Price Maintenance in China: An Economic Perspective' 3 JOURNAL OF ANTITRUST ENFORCEMENT (Suppl. 1), i132, i140-1 (2015).

24 NDRC, *Penalty on Corrective Lenses Producers' RPM Practices* (部分眼镜镜片生产企业维持 转售价格行为被依法查处) (May 29, 2014).

25 Jiangsu Province Price Bureau, *Price Bureau Of Jiangsu Province imposes administrative penalty on Mercedes-Benz for price monopoly* (江苏省物价局对奔驰公司价格垄 断案作出行政处罚) (May 18, 2015); Hubei Provide Price Bureau, *Penalty on FAW-Volkswagen and Audipart distributors in Hubei for price monopoly* (一汽大众销售有限责任公司部分奥迪经销商 在湖北实施价格垄断被处罚) (Sept. 11, 2014); Shanghai Development and Reform Commission, *Penalty on Chrysler and part distributors in Shanghai for price monopoly* (Sept. 11, 2014) (克莱斯勒及上海地区部分经销商实施价格垄断被依法查处); Guangdong Development and Reform Commission, *Penalty on Dongfeng Nissan for price fixing* (东风日产在广东省实施价格垄断被处罚) (Sept. 10, 2015).

26 NDRC, administrative penalty decision, *Medtronic (Shanghai) Management* (Dec. 7, 2016). See also Ken Dai and Jet Deng, *Managing Distribution and Antitrust Compliance in China: Post Medtronic and* GM, COMPETITION POLICY INTERNATIONAL (Feb. 2017), https://www.competitionpolicyinternational.com/wp-content/uploads/2017/02/Asia-Column-February-Full-1.pdf.

27 Bu, *supra* note 13, at 120; Britton Davis, *China's Anti-Monopoly Law: Protectionism or a Great Leap Forward?*, 33 BOSTON COLLEGE INTERNATIONAL AND COMPARATIVE LAW REVIEW 305, 321 (2010).

28 *Yutai, supra* note 5.

29 *Hainan Yutai Technology Feed Co., Ltd. v. Hainan Price Bureau*, (2017) Qiong 01 Xing Chu No. 681.

30 *Hainan Yutai Technology Feed Co., Ltd. v. Hainan Price Bureau*, (2017) Qiong Xing Zhong No. 1180

31 *Yutai, supra* note 5.

32 Sandra Marco Colino, *The Incursion of Antitrust into China's Platform Economy*, 67 ANTITRUST BULLETIN 237, 249 (2022).

33 See *supra* section II.

V. YUTAI AFTERMATH: AML REFORM AND RECENT DECISIONS

Consistent with the ruling of the Supreme People's Court in *Yutai*,[34] it is now understood that minimum RPM can be considered unlawful by enforcers without the need to prove anticompetitive effects. However, according to the changes introduced in the AML reform that entered into force in August 2022, these practices will not be prohibited in the event that "the undertaking can prove that [the conduct] does not have the effect of eliminating or restricting competition."[35] Moreover, the AML revision opens the door for a safe harbor for vertical agreements when the market share of the parties does not exceed certain thresholds, to be determined by the competition authorities.[36]

Since *Yutai*, administrative decisions appear to follow the Supreme People's Court position. In 2021, Yangtze River Pharmaceutical Group was punished for imposing minimum RPM contractually and informally.[37] It monitored online prices and used threats against distributors not complying with its price The State Administration for Market Regulation ("SAMR") delved into the advantages of maintaining high retail prices for Yangtze River, and the dependence of its distributors on the company given its market power. As is common in administrative enforcement, the relevant market was not defined. Despite the detailed analysis, the SAMR rejected Yangtze River's claim that effects would need to be proven, and imposed a RMB 764 million fine. Relying on Yutai, it stated that these practices are prohibited in principle by the AML, and Yangtze River had failed to show the application of any Article 15 exceptions. Moreover, the pharmaceutical company had not demonstrated that its actions a) would not restrict competition in the market, and b) would allow consumers to participate in any potential benefits. The penalty imposed represents 3 percent of the company's revenue.

The above position affirms the uniqueness of Chinese competition law. The rule of reason analysis applied in the United States since the US Supreme Court's *Leegin* judgment has been rejected in the context of administrative enforcement, but may be relevant in civil litigation for the award of damages.[38] The Chinese approach appears to be more consistent with that of the European Union's, which considers vertical price fixing and minimum RPM inherently harmful in the absence of an exception (which would need to be demonstrated by the parties). However, rather than showing that the practice bore no effects, in the EU the undertakings are required to prove that any anticompetitive effects would be justified by the existence of efficiencies, meeting the conditions laid down in Article 101(3) of the Treaty on the Functioning of the European Union ("TFEU").[39]

VI. CONCLUSION

The Supreme People's Court 2018 *Yutai* judgment and the amendment of the AML implemented in 2022 have helpfully clarified the legal framework applicable to vertical price restraints in China. Following these developments, it appears that "prohibition in principle plus exemption" means that vertical price fixing and minimum RPM can be considered unlawful without the need for antitrust agencies to show effects. At the same time, companies have been afforded the opportunity to demonstrate the absence of effects, which could lead to a finding of compatibility with Article 14 of the AML. The kind of evidence that will be accepted as proof of absence of effects is unclear, since no company has to date been successful in reverting the presumption of illegality of these restrictions.

The resulting legal landscape enables enforcers to punish vertical price restraints without the need to enter into complex effects analysis, and eschewing relevant market definition. As a consequence, it should allow the AMEAs to tackle the negative consequences associated with these restrictions. In the context of private litigation however, plaintiffs will still need to prove harm to be awarded damages.

34 *Yutai, supra* note 4.

35 AML reform, *supra* note 4.

36 *Ibid.*

37 SAMR, Administrative Penalty Decision (2021) No. 29, *Yangtze River Pharmaceutical Group*.

38 *Leegin Creative Leather Products Inc. v. P.S.K.S. Inc.* (2007) 127 U.S. 2705, 2719. It should be noted that some US states still treat minimum RPM as being per se illegal.

39 Treaty on the Functioning of the European Union [2012] OJ C326/47.

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