China's Supreme People's Court Rules RPM Is Illegal *Per Se*

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In a ruling issued on December 18, 2018 but not published until June 24, 2019, China's Supreme People's Court (SPC) ruled in favor of the Hainan Provincial Price Bureau in an administrative proceeding regarding a vertical price agreement with respect to products for resale to third parties (so-called Resale Price Maintenance or RPM). This is the first judicial review of a vertical price monopoly agreement dispute between a private party and an anti-monopoly enforcement agency (AMEA) by the nation's highest court which for now resolves the conflict between the different approaches adopted by the AMEA and the judiciary with respect to vertical agreements, making it a landmark case in Anti-Monopoly Law (AML) enforcement.

Before consolidation into a single AMEA known as the State Administration of Market Regulation (SAMR) in March 2018, the AMEA in change of conducting investigations and imposing penalties under the AML and the Provisions on Anti-Price Monopoly was the National Development and Reform Commission (NDRC). Since 2013, NDRC has fined companies for concluding RPM agreements in industries including infant formula, optical lenses and automobiles.[1]

In February 2017, the Hainan Provincial Price Bureau fined Hainan Yutai Scientific Feed Company (Yutai), a fish feed company, RMB 200,000 for concluding RPM agreements with its distributors in 2014 and 2015, in violation of Article 14(1) of the AML,[2] even though the agreements were apparently never implemented. Yutai filed for judicial review with the Haikou Intermediate People's Court which ruled against the penalty in March 2017, citing incorrect application of the AML.[3] This is the first and only instance where an AMEA lost a case in a people's court since the AML took effect in August 2008.

The Price Bureau appealed the ruling to the Hainan Higher People's Court which overturned the decision of the lower court and upheld the penalty in December 2017. Yutai then appealed to the SPC in July 2018.

The SPC affirmed the decision of the higher people's court to reject Yutai's appeal and ruled in favor of the Price Bureau. In its ruling the SPC acknowledged and reaffirmed the obviously different review criteria adopted by AMEA and the courts with respect to the legality of "vertical" agreements under Article 14 of the AML, i.e., agreements between businesses and their distributors, wholesalers or retailers, as opposed to agreements between competitors ("horizontal" agreements under Article 13

of the AML).[4] The SPC ruled that it is not improper for courts to employ a "rule-of-reason" approach to determine if a vertical agreement eliminates or restricts competition.[5] But the AMEA by contrast should treat vertical agreements including RPM as monopoly agreements and *per se* AML violations without the burden of proof for anticompetitive effects.

In its ruling, the SPC stated that RPM agreements under Article 14 of the AML are typical vertical monopoly agreements which often have a double-edged effect that both limits and promotes competition. However, because market conditions at present are relatively immature and the capacity of markets for self-correction is relatively weak, AMEAs should emphasize prevention of the anticompetitive effects of such vertical monopoly agreements, and make the regulation and punishment of such agreements a focus of their AML enforcement activity.

From a comparative perspective the SPC does not appear to fundamentally reject the holding in Leegin by the Supreme Court of the United States (SCOTUS) which reversed a century of antitrust law in the US by finding that such agreements may or may not be unlawful because they may have procompetitive as well as anticompetitive effects and therefore need to be reviewed subject to the rule of reason rather than deemed *per se* illegal.[6] The SPC instead appears to have ruled that China's economy has yet to mature sufficiently to allow the AMEA to apply the rule of reason. The SPC implied, however, that its view is subject to change as the economy matures and AMEA capability increases.

Respect for the views of the US antitrust agencies also influenced the SCOTUS majority in Leegin. As Justice Kennedy wrote for the majority: "It is also significant that both the Department of Justice and the Federal Trade Commission – the antitrust enforcement agencies with the ability to assess the long-term impacts of resale price maintenance – have recommended that this Court replace the *per se* rules with the traditional rule of reason."[7]

The SPC further stated that in the early stage of the development of both the economy and AML enforcement, requiring AMEAs to conduct comprehensive investigations and complicated economic analysis on vertical monopoly agreements in order to determine their impact on market competition would substantially raise enforcement costs and impact enforcement efficiency, which would be incompatible with the present need for AML enforcement activity.

In sum, the SPC ruled that RPM generally constitutes a monopoly agreement under Article 14 of the AML which meets the criteria of eliminating or restricting competition as stipulated under Article 13 of the AML.[8] When RPM is uncovered by the relevant AMEA during its investigation, a monopoly agreement may be deemed to have been reached without the AMEA shouldering the burden of proof of showing anticompetitive effects. A business operator may rebut such allegation by proving that the agreement does not eliminate or restrict competition, or by invoking an exemption under Article 15 of the AML.[9] The AMEA is required to determine whether an exemption applies.

The SPC's ruling is now also in accordance with the Interim Provisions on the Prohibition of Monopoly Agreements (Interim Provisions) issued by SAMR on July 1. The Interim Provisions enumerate several types of monopoly agreements including RPM[10] and specify that the enumerated monopoly agreements are to be deemed *per se* illegal, while applying the rule of

reason to other types of anticompetitive agreements not specifically enumerated.[11] Now that SAMR's regulatory posture has both been endorsed by the SPC, at least for the time being, and formalized in the Interim Provisions, business operators need to be cautious about imposing pricing requirements on their distributors and/or retailers to avoid administrative and civil litigation under the AML.

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1. For more information, *see, e.g.*, https://www.uschamber.com/sites/default/files/aml_final_090814_final_locked.pdf.

2. *See* AML, Article 14(1): A business operator is prohibited from concluding the following monopoly agreements with its trading partners: (i) fixing the prices of commodities resold to a third party; (ii) restricting the lowest prices for commodities resold to a third party; and (iii) and other monopoly agreements determined as such by the relevant AMEA.

3. The Haikou Intermediate People's Court believed that in order for Article 14(1) of the AML to apply, the agreement at issue needed to meet the conditions set forth in Article 13(2), i.e., the agreement should have the effect of eliminating or restricting competition. However, evidence showed that given the sales volume and market share of Yutai, there were no anticompetitive effects, and therefore Article 14(1) of the AML should not apply to the case.

4. *See* AML, Article 13(1). Horizontal agreements include monopoly agreements on fixing or changing commodity prices, restricting the quantity of commodities manufactured or marketed, dividing a sales market or a procurement market for raw and semi-finished materials, restricting the purchase of new technologies or equipment or the development of new technologies or products, joint boycott of transactions, and other monopoly agreements as determined by the AMEA.

5. The SPC, in its ruling, commented on Shanghai Higher People's Count's decision on *Rainbow v. Johnson & Johnson* and stated that in civil litigations, it is not improper for the court to determine whether to uphold the plaintiff's claims based on whether the monopoly agreement eliminates or restricts competition.

6. *See Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (overturning *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 313 (1911)).

7. *See Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 899 (2007).

8. *See* AML, Article 13(2): For the purposes of this Law, a monopoly agreement is an agreement, decision or other concerted practice which eliminates or restricts competition.

9. *See* AML, Article 15: Articles 13 and 14 shall not apply If the business operators can prove that the concluded agreements fall into any of the following circumstances: (i) improving technology, or researching and developing new product; (ii) improving product quality, reducing costs, enhancing efficiency, harmonizing product specifications and standards, or dividing work based on specification; (iii) improving the operational efficiency and enhancing competitiveness of small and medium-sized enterprises; (iv) serving public interests such as energy saving, environmental protection and disaster relief and aid; (v) alleviating serious decreases in sales volumes or significant production overcapacities during economic recession; (vi) safeguarding legitimate interests in foreign trade and foreign economic cooperation; (vii) other circumstances determined by the law and by the State

Council. For agreements falling under indents (i) to (v), the business operators are further required to prove that the concluded agreement does not significantly restrict competition in the relevant market and allows consumers a share of the resulting benefit in order for Articles 13 and 14 not to apply.

10. *See* Interim Provisions, Articles 7-11 enumerate specific types of horizontal agreements, and Article 12 enumerates three types of vertical agreements as listed in Article 14 of the AML.

11. *See* Interim Provisions, Article 13 provides that other agreements not listed in Articles 7-12 of the Interim Provisions shall be treated as monopoly agreements if they are proved to eliminate or restrict competition. To determine whether an agreement is monopolistic, SAMR shall consider factors including (i) the fact that the business operators have entered into and implemented the agreement, (ii) competition condition of the market, (iii) market share of the business operators, (iv) the agreement's impact on commodities' price, volume and quality, (v) the agreement's impact on market entry and technology improvement, (vi) the agreement's impact on customers and other business operators and (vii) other factors.

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