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The J&J Vertical Price-Fixing Litigation in China

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Johnson & Johnson Medical (China) Ltd. ('J&J Medical') and its Shanghai branch are sued in China for minimum resale price maintenance (RPM) by a Beijing-based distributor. This is the first private litigation that challenges RPM pursuant to China's [Anti-Monopoly Law \(AML\)](#).

The Facts

Rainbow Medical Equipment & Supplies Co. ('Rainbow') distributed J&J suturing products for 15 years. The distribution agreements were reached annually. In January 2008, Rainbow signed a one-year distribution agreement with J&J Medical and its Shanghai branch ('J&J Medical Shanghai'). According to the agreement, Rainbow was authorized to sell J&J suturing products to hospitals in allocated regions of Beijing above minimum resale prices set by J&J Medical and J&J Medical Shanghai. In March 2008, J&J Medical Shanghai found that Rainbow had quoted suturing products below the price floor in a bid and won business in a hospital outside its allocated regions. J&J Medical Shanghai deducted Rainbow's deposit in July 2008, suspended and then terminated Rainbow's distribution rights in several hospitals, and, since August 2008, terminated the delivery of suturing products to Rainbow.

The Court Proceedings

Rainbow filed a suit in the Shanghai No. 1 Intermediate People's Court against J&J Medical and J&J Medical Shanghai, alleging that the defendants had engaged in minimum RPM in violation of Article 14(2) of the AML and claimed damages of CNY 14.4 million ([J&J RPM case](#)). The [court accepted the case](#) in September 2010 and heard the case on 3 February 2012. The hearing lasted for six hours and the court has yet to render judgment.

The Defendants' Arguments

The defendants argued that the distribution agreement was signed before the AML took effect on 1 August 2008; therefore the AML did not apply because, as a general rule under the Chinese law, laws do not have retrospective effect. The defendants also argued that the AML prohibits minimum RPM only if it causes a restrictive or eliminative effect on competition and the vertical pricing arrangement in this case did

not adversely affect competition. Furthermore, the defendants argued that bilateral monopoly conduct injures third parties. Rainbow, as a party to the disputed distribution agreement, was not injured and therefore is not an eligible plaintiff.

The J&J RPM case poses several challenges.

The Applicability of the AML

First, the applicability of the AML to the J&J RPM case remains to be judged. The AML was promulgated on 30 August 2007 and took effect on 1 August 2008. Prior to the AML, with the exception of the [Administrative Measures on Fair Trading between Retailers and Suppliers](#) that prohibit RPM compelled by powerful retailers, RPM is left unattended in China. Moreover, the property law doctrine governing the restraints on alienation does not exist in China. Thus, unhappy discounters had no legal rules and principles to rely upon before 1 August 2008. However, from 1 August 2008, the AML should apply to agreements continuing in effect and the parties had time (the 11 months between the AML promulgation date and effective date) to assess and amend the agreements in order to comply with the AML.

However, the J&J RPM case can be a bit tricky. The defendants terminated the supply since August 2008 in response to the plaintiff's breach of agreement (the price cutting) that took place in March 2008. The contractual period was the whole year and it is currently unclear whether the distribution agreement was legally terminated before the AML took effect.

The Legality of RPM

Second, the J&J RPM case tests the court's ability to handle complicated and often debatable vertical price-fixing issues. A focus of the hearing of the J&J RPM case was whether minimum RPM constitutes a monopoly agreement per se or it is only an essential factor for the finding of a monopoly agreement.

As previously reported in the [Dongfeng Nissan case](#), Article 14 of the AML prohibits vertical agreements that fix resale prices or set minimum resale prices, and prohibits other types of vertical 'monopoly agreements as determined by the anti-monopoly enforcement agencies (AMEAs)'. Vertical agreements can be exempted under Article 15 of the AML provided that they meet a set of broad criteria. To date, the AMEAs have neither published any decisions in relation to vertical restraints nor issued implementing regulations to clarify Articles 14 and 15 of the AML. Thus, it remains unclear whether fixed and minimum RPM will be subject to rule of reason scrutiny or will be considered as non-exemptible hardcore restrictions in China.

The Prospect of Private Enforcement

Third, the J&J RPM case reveals circumstances that may keep alive the prospect of private enforcement of the AML. For example, so far vertical restraints are not among the AMEAs' enforcement priorities and there is no timetable when the AML implementing regulations regarding vertical restraints will be promulgated. On the other hand, disputes arising from distribution arrangements have been reported widely in China, such as punishments imposed by car manufacturers on dealers for

cross-region sales and sales below price floor, and high access payments charged by large retailers on suppliers. Therefore, gaps exist between the needs of the Chinese market and the AMEAs' enforcement priorities and rule-making activities. Further, the AMEAs are in a long-term continual process of capacity building and they currently lack the resources to handle growing numbers of cases and complaints. The situation encourages claimants to seek redress in the courts.

The AML has been in force for over three years and claimants have actively tested the boundaries of the AML through private litigation. It is expected that China's Supreme People's Court will issue the judicial interpretations on private antitrust litigation within a year. Although the courts have yet to deliver any judgments favouring the plaintiffs and China's judiciary traditionally plays a less active role in shaping the law, the trend of the increased awareness of antitrust damages claims is likely to continue.

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For information of the Johnson & Johnson RPM case, see the [China Competition Bulletin](#), Edition 17, January/February 2012.

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