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New framework for resale price maintenance analysis in China

Adrian Emch (Hogan Lovells, China) · Monday, July 22nd, 2019

In the last week of June 2019, a copy of a ground-breaking court ruling emerged on social media in China – the order by the Supreme People’s Court (SPC) in the case between Yutai Technology Feed (**Yutai**) and the Hainan Price Bureau.

The order provides a direct answer to the question of whether or not the Chinese antitrust authorities bear the burden to prove the anti-competitive effects of companies’ resale price maintenance (**RPM**) conduct. China’s highest court found that they do not.

Background

The case started with an investigation by the Hainan Price Bureau, a local affiliate of the then-antitrust authority with jurisdiction over anti-competitive pricing conduct, the National Development and Reform Commission. In its investigation, the Price Bureau found that Yutai (as the supplier of fish feed) had a clause in its contracts with distributors which stipulated that the distributors had to follow the “guiding prices” set by Yutai in their resale to third parties. A deviation from those prices would give Yutai the right to withdraw benefits from the distributors. The Price Bureau found this arrangement to amount to RPM.

At the same, it was clear in the administrative procedure before the Price Bureau that Yutai had not enforced the clause in practice. On that basis, the Price Bureau concluded that Yutai had entered into – but not implemented – an RPM agreement in violation of Article 14 of the Anti-Monopoly Law (**AML**) and fined the company RMB 200,000 (around USD 30,000).

Yutai appealed the Price Bureau’s decision before the Haikou Intermediate People’s Court, which annulled the decision on the ground that the authority had not proven that the RPM agreement had anti-competitive effects in the market.

The Price Bureau appealed the Intermediate People’s Court judgment before the Hainan High People’s Court. That court overturned the first-instance judgment, holding that the Price Bureau was not required to prove anti-competitive effects.

Yutai further appealed against the Hainan High People’s Court judgment (by way of request for retrial) before the SPC. The SPC issued the final ruling in the case with an order dated 18 December 2018.

SPC ruling

The SPC started its analysis on the substance in a broad way, referring to the goals of the AML and to several policy developments. It then laid out a general principle – making a distinction between agreements which are per se violations of the AML, and agreements whose violation can only be established after a detailed analysis. The court listed price fixing, output restriction, and market partitioning as examples of per se violations. In turn, the court found a detailed analysis to be required for agreements “other than the agreements where the per se illegality principle is used.” The court further mentioned the following factors to be used in the detailed analysis: the specific market conditions, the change of market conditions before and after implementation of the agreement, and the nature and effect of the agreement.

After these initial, somewhat theoretical explanations, the SPC went closer to the key issue of the case – whether a showing of anti-competitive effects is required for an RPM finding.

The SPC first held that RPM is a typical vertical agreement which often has both pro- and anti-competitive effects.

The court then found that the Chinese marketplace as such is not yet fully developed and the market’s self-healing function is still weak. Against this background and taking into account that China is still at the beginning of its antitrust enforcement history, the court held that it was not appropriate to require the antitrust authorities to make a full-blown investigation and complex economic assessment in each RPM case. Doing so would greatly increase costs and decrease the efficiency of antitrust enforcement. In the SPC’s view, this would not be in line with the current needs of China’s antitrust regime.

As a result, the court found, the antitrust authorities are not required to prove that an RPM agreement restricts competition. On the contrary, the onus is on the company under investigation to prove the absence of a restriction of competition or the applicability of the exemption clause (Article 15 of the AML, which lists certain pro-competitive or social factors such as technology improvement, product quality enhancement, environmental protection etc.).

Applying these principles to the case at hand, the SPC found that Yutai had failed to provide sufficient evidence that its conduct did not significantly restrict competition in the market. The court ruled that the first-instance finding that Yutai’s scale of operations and market share showed the lack of anti-competitive effects was not supported by evidence and in-depth analysis, hence erroneous. Even though the Price Bureau had accepted in the administrative procedure that Yutai had not implemented the RPM clause, the SPC held that the clause would still have the *potential* of restricting competition. In the court’s view, the analysis of whether an agreement restricts (potential) competition is different from an analysis of the agreement’s effects or the actual harm suffered by a market player.

Although the above reasoning would have allowed the court to stop its analysis there, it continued by distinguishing the *Yutai* case from prior judgments by lower courts, in particular the Shanghai High People’s Court’s judgment in *Rainbow v. Johnson & Johnson*. In that case, the Shanghai court had required plaintiffs in private antitrust lawsuits to prove the anti-competitive effects of RPM conduct as a pre-condition for a successful claim. In contrast, in *Yutai*, the SPC explicitly ruled that the standard of proof for administrative litigation (*i.e.*, challenging the antitrust

authorities' decisions) differs from that for civil litigation. According to the SPC, the reason is that a plaintiff in a civil lawsuit has to prove the actual damage suffered, an analysis closely related to the question of anti-competitive effects.

As a final point, the SPC noted the recent institutional reform and creation of the State Administration for Market Regulation (**SAMR**) with its unified antitrust enforcement powers in spring 2018, and found that SAMR should issue guidance to market players on vertical agreements.

Comments

The *Yutai* order is one of the few antitrust rulings by China's highest court. Its impact is significant. The SPC attempted to give guidance to the antitrust authorities and the lower courts on the substance of AML enforcement.

In *Yutai*, the SPC "got its hands dirty," going out to clarify the law in an area where there has not been detailed guidance on how to interpret the AML. It did so by refining the substantive antitrust analysis for examining agreements under the AML, by way of allocating the burden of proof and using presumptions which were not explicitly written into the law.

In the ruling, the SPC attempted to overcome the divergence between authority decisions and lower court judgments on what is required to bring a successful RPM case. Its reasoning suggests a compromise between two positions – that RPM is per se illegal (with no possibility of rebuttal), and that the antitrust authorities would need to conduct a comprehensive rule of reason analysis. In essence, the SPC found that RPM is subject to a rule of reason analysis, but that the burden is on the company targeted in an administrative procedure to prove the absence of anti-competitive effects.

The reasons for the SPC's findings were quite clear. Using somewhat different language, the court seemed to suggest that the relative immaturity of the Chinese market (given that China started transitioning from a planned to a market economy "only" a few decades ago) means over-enforcement may be more acceptable than under-enforcement at this stage. The SPC implied that an effects analysis for each RPM case would impose an excessive administrative burden on SAMR and its local offices, given the significant manpower shortage of the SAMR antitrust teams – at least at the central level in Beijing.

In *Yutai*, the SPC also laid out a benchmark for the effects analysis that is required for an RPM case. In the administrative procedure, even the Price Bureau had accepted that *Yutai* had not implemented the RPM clause. On that basis, *Yutai* argued that the lack of implementation means there were no negative effects on competition. Possibly to by-pass that argument, the SPC found that a showing of a *potential* restriction of competition is sufficient. Future cases will show whether or not the court set a (very) low benchmark for effect analyses for RPM and possibly other cases.

The *Yutai* ruling is also significant beyond the narrow RPM question. Indeed, the SPC proposed to follow the per se / rule of reason dichotomy of types of agreements in an almost identical way to the concepts as they are known on the international stage. In a way, the court came in to fill a void left open by the AML and its implementing rules, and to align AML enforcement with

international practice.

Given the SPC's pro-active suggestion to SAMR to issue enforcement guidelines on vertical agreements, this may not be the last time the SPC intervenes if it believes the authorities fail to provide sufficient guidance.

For companies doing business in China, the *Yutai* ruling is a double-edged sword. On the upside, the ruling explicitly confirms RPM is subject to a rule of reason analysis, which in principle allows a showing of the conduct's pro-competitive effects (by reference to factors such as low market shares, negative impact of free-riding by distributors, new market entry, etc.).

On the downside, once the RPM obligation on distributors is evidenced (through contractual clauses or otherwise), the burden is on the company to justify why the RPM arrangement does not restrict competition. Yet there is little guidance as to what justifications will be accepted by SAMR and its local offices. Arguing justifications "in defense" has always been a difficult endeavor in antitrust proceedings, in China and beyond. The stance of SAMR and its predecessor body, in practice, was that RPM is essentially per se illegal. A change in the enforcement culture and the attitude of the regulators is needed as much as a change in the text of the law. Hopefully, the *Yutai* ruling will bring about that change, and give companies involved in RPM investigations enough confidence to forcefully argue their case before the antitrust authorities.

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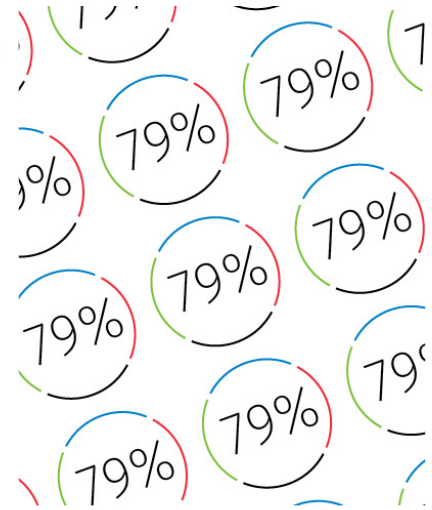
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