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Resale Price Maintenance in China – Safe Harbour or Stormy Seas?

Adrian Emch (Hogan Lovells, China) · Thursday, June 15th, 2023

On 29 May 2023, China’s antitrust authority – the State Administration for Market Regulation (“SAMR”) – published the [decision against Zizhu Pharma](#) on its webpage. The company was fined by SAMR’s Beijing branch for engaging in resale price maintenance (“RPM”), the antitrust lingo for describing a supplier forcing its distributors to follow minimum resale prices.

The *Zizhu Pharma* decision is not particularly noteworthy on its own. However, its impact is significant: it confirms that SAMR’s plan to provide a “*safe harbour*” for certain RPM conduct is currently on hold.

Zizhu Pharma decision

Zizhu Pharma is a pharmaceutical company based in Beijing. Its flagship product is the levonorgestrel tablet, an anti-contraception pill.

In the *Zizhu Pharma* decision, the Beijing Administration for Market Regulation (“BAMR”) held that the company had imposed minimum resale prices on its distributors from 2015 to 2021. The obligations were imposed in the one-on-one distribution agreements with tier 1 distributors as well as the three-party agreements between Zizhu Pharma with tier 1 and tier 2 distributors. Zizhu Pharma was found to have implemented the RPM conduct by (1) maintaining channel price management with detailed detection, monitoring, and sanction rules for distributors reselling below the fixed minimum prices, (2) contracting a third-party data company to monitor distributors’ resale prices, and (3) setting up a reward/sanction mechanism for the sales team’s enforcement of the minimum resale prices.

In its decision, BAMR highlighted that Zizhu Pharma was a well-known brand with “a good reputation and relatively strong impact” and otherwise praised the company’s product. The decision also stressed that the company’s conduct led to price convergence among distributors. However, the decision fell short of mentioning Zizhu Pharma’s market share for the levonorgestrel tablet.

As a result of its findings, the BAMR found Zizhu Pharma to have breached the RPM prohibition in the Anti-Monopoly Law (“AML”) and imposed a fine of RMB 12.6 million (approximately USD 1.8 million), 2% of the company’s annual revenues.

Safe harbour? Not yet

Last summer, the AML was amended for the first time since its entry into effect in 2008. The amended AML changed the rules on RPM, empowering SAMR to set a market share “safe harbour” below which RPM would no longer be illegal.

Unfortunately, however, when SAMR issued [amended implementing regulations](#) to fit the AML amendment, it did not put forward a numeric market share threshold (as it had done in the draft regulation circulated for public comment, at 15% market share), but merely repeated the language in the amended AML. In other words, it let pass the perfect opportunity to provide legal certainty to the business community by setting out a clear market share safe harbour (see our alert [here](#)).

There are speculations about why SAMR decided not to take up the AML mandate, for example, that it preferred to stipulate the market share threshold in an easier-to-change guideline instead of a regulation. Rumour has it that such a guideline could be issued in the short- or mid-term.

It is against this background that the *Zizhu Pharma* decision becomes relevant – implying that SAMR may be comfortable with the status quo for the time being. As a result, businesses should focus their compliance on the current SAMR enforcement practice, not wait for any guidance with a market share threshold.

Admittedly, *Zizhu Pharma*’s RPM conduct ended before the amended AML came into effect in August 2022, which allowed BAMR to apply the AML pre-amendment. However, Chinese administrative law contains an exception to the general non-retroactivity doctrine: if conduct previously illegal becomes legal under new rules, the new rules apply retroactively. Applied to the case at hand, this would mean that conduct below the market share safe harbour might be illegal before, but would be legal after the AML amendment. Yet, in the *Zizhu Pharma* decision, there is no discussion on this point. The decision does not mention the company’s actual market share.

This point is similar to the other RPM sanctioning decisions by SAMR’s local branches since the announcement of the AML amendment in June 2022, i.e., the *Eshun Pharma* and *Sesame English Street* and *Straumann* cases. In all these cases, the decisions discussed negative effects on competition, but none mentioned the companies’ market shares.

The message that the *Zizhu Pharma* decision conveys is therefore clear: SAMR and its local branches continue their RPM enforcement as before. Accordingly, it is very difficult for businesses to rebut the de facto presumption of illegality by showing a low market share or the absence of anti-competitive effects.

For companies doing business in China, this means that – in order to keep risks as low as possible – RPM should be treated as a hardcore offence of the AML, and sufficient compliance measures should be in place to prevent such risks from materializing.

The way forward – some silver linings

The AML’s prohibition against RPM conduct is very intrusive for businesses, which are generally

keen to retain some sort of control or direction over distributor pricing.

In some other antitrust jurisdictions, there is an increasing recognition that RPM can have positive effects on competition and therefore be a legitimate business practice, at least in certain circumstances.

If companies in China had hopes that the AML's *de facto* "hardcore" prohibition of RPM would be changed into a more flexible approach – with a market share safe harbour giving legal certainty – they would be disappointed by the lack of implementation in the SAMR regulation and the continued enforcement practice (with *Zizhu Pharma* being the last decision in this area).

That said, however, not all is bleak. For one, there is still hope that SAMR will implement the AML's safe harbour provision in a future guideline or other legal rules.

In addition, there are other developments in the RPM which may provide silver linings. On the one hand, a [new draft guidance document](#) issued by China's highest court – the Supreme People's Court – for public comment in November 2022 confirmed that a supplier's determination of "resale" prices by genuine agents (as opposed to distributors) does not fall under the AML. The pre-condition is that the agents do not carry substantial commercial or operational risks for the distribution.

The "genuine agent exemption" to the RPM prohibition is different from and therefore comes on top of, the "fulfilment contract exemption" in the [antitrust guidelines for the automotive sector](#), which exempts resale determination by carmakers and other suppliers in the automotive sector if the distributors involved are "middlemen" without authority, merely executing the transactions agreed between the suppliers and the end customers.

On the other hand, in *U-blox AG v. Shenzhen T-MAX Technology*, a recent judgment from a local court in Shenzhen – decided in April 2021 and made public in June 2022 – ruled that setting the manufacturer's supply price (for the sale from the manufacturer to the distributor) based on the distributor's resale price (for the resale to the end customer) did not amount to RPM because the distributor was free to determine the resale price to the end customers.

The importance of the Supreme People's Court guidance and the Shenzhen judgment should not be overlooked. Both mean that suppliers have options on how to restructure their distribution set-up, even though it is clear that such restructuring may have a significant and potentially costly impact on their business model.

* The piece is a re-post from the author's original client alert, see [here](#).

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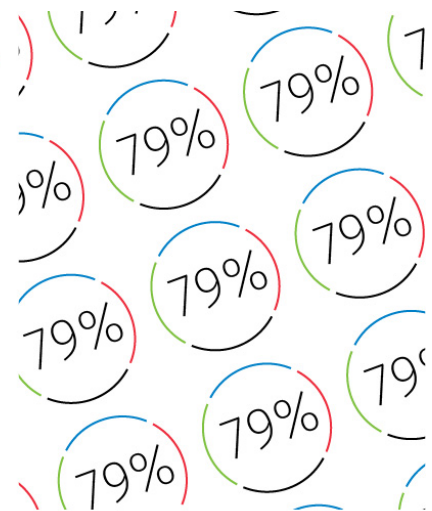
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