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How China Deals with the Diverging Approaches to Monopoly Agreements

Over the first decade of China's Antimonopoly Law, we have seen a divergence between the approaches adopted by the Chinese antimonopoly enforcement agencies and the Chinese courts towards agreements that restrain trade; what in China are called "monopoly agreements," especially vertical agreements. The key difference is whether proof of anticompetitive effect is a necessary element to find an illegal agreement. Both the AMEAs and the courts have tried to converge their approaches. Until these conflicting approaches are unified, it is safer for companies operating in China to continue assuming that essentially all monopoly agreements involving cartels and resale price maintenance will be treated as per se illegal.

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Over the first decade of China's Antimonopoly Law ("AML"), we have seen a divergence between the approaches adopted by the Chinese antimonopoly enforcement agencies ("AMEAs") and the Chinese courts towards agreements that restrain trade, of what in China are called "monopoly agreements," especially vertical agreements. The key difference has been with regard to whether proof of anticompetitive effect is a necessary element to find an illegal agreement.

The AMEAs tend to believe that once a conduct falls into the scope of monopoly agreements proscribed by the AML, there is no need to further prove the anticompetitive effects. On the other hand, courts pay much more attention to the effects of the alleged monopoly agreement. As a result, an alleged violator with relatively low market share is likely to be fined by the AMEAs for monopoly agreements, but may win a civil action defending its conduct.

Both the AMEAs and the courts have tried to converge their approaches, with the Hainan High Court's *Yutai* case being the most recent high-profile effort. Unfortunately, until these conflicting approaches finally are unified, it is safer for companies operating in China to continue assuming that essentially all monopoly agreements involving cartels and resale price maintenance will be treated as *per se* illegal, rather than relying on the possibility of arguing a lack of anticompetitive effects, regardless of their market positions.

THE "PROHIBITION + EXEMPTION" APPROACH UNDER THE AML

The AML Chapter 2 "Monopoly Agreements" is roughly comparable to the U.S. Sherman Act § 1 and Article 101 of the EU Treaty: Article 13 of the AML deals with horizontal monopoly agreements, which it defines as "agreements, decisions, or other concerted conducts that eliminate or restrict competition." Article 14 focuses on vertical monopoly agreements, particularly resale price maintenance ("RPM"). Article 15 provides for the exemption of monopoly agreements from prohibition under certain circumstances. In short, the AML appears to make clear that monopoly agreements falling under Articles 13 or 14 are prohibited unless an exemption applies under Article 15.[1]

In the past, two AMEAs, the National Development and Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC"), shared responsibility of investigating monopoly agreements. The NDRC focused on cases involving price restrictions, while SAIC regulated other non-price matters. Both agencies also had provincial branches—provincial Development and Reform Commission ("DRCs") and provincial Administration for Industry and Commerce ("AICs") that were authorized to enforce the AML too. According to the government restructuring plan approved by the National People's Congress on March 13, 2018, NDRC, SAIC and MOFCOM (responsible for merger review) are in the process of integration into one antitrust enforcement agency under the Market Supervision Bureau.

Such an "administrative + judicial" antitrust enforcement system is quite common worldwide. However, as shown below, different interpretation and understandings of the monopoly agreement provisions of the AML have resulted in a substantial divergence between the AMEAs and the Chinese courts that is still being settled.

DIVERGING APPROACHES TO VERTICAL AGREEMENTS

Article 14 of the AML specifically prohibits resale price maintenance, but also has a catch-all clause authorizing the AMEAs to designate as violations "other monopoly agreements" not specifically listed in the AML. So far, the AMEAs have focused mainly on RPM cases.[2] Although the AMEAs have never stated that they address vertical agreements as *per se* illegal, the practical effect of their enforcement approach to date has been very close to a *per se* standard, similar to the approach used in the United States prior to the *Khan* and *Leegin* cases, which introduced the rule of reason for RPM. On the other hand, the Chinese courts generally have applied a type of *rule of reason* analysis to vertical agreement cases, even RPM.

The Vertical Enforcement Approach of the AMEAs

In the early days of its enforcement efforts, the NDRC investigated and issued fines in some high-profile vertical agreement cases without engaging in any detailed anticompetitive effects analysis. In the *Chinese liquor* case (2013), a total fine of RMB 449 million was imposed on two domestic liquor producers, Moutai and Wuliangye, for implementing RPM. In the *infant formula* case (2013), six infant formula manufacturers were fined a total of RMB 668 million for fixing resale prices. Although no

formal decisions have been released for these two cases, it seems that the NDRC's approach was straightforward—once the parties' conduct was found to constitute RPM, then no anti-competitive effects analysis was required.

In the recent years, it appears that the AMEAs have tried to pay more attention to anticompetitive effects. In late 2016, NDRC imposed a RMB 118.5 million fine on a US company that used fixed and minimum resale prices for its medical device products. In its decision, NDRC provided a comparatively detailed analysis of the anticompetitive effects of the RPM conduct, on both inter-brand competition and intra-brand competition.

However, the analysis and approach so far have not been very consistent among the AMEAs and their provincial branches. In other vertical agreement cases, for example, *Speed Fresh Logistics* (2016) and *Hankook Tire* (2016), the Shanghai DRC provided no anticompetitive effect analysis at all.

The Approach of the Chinese Courts to Vertical Agreements

By contrast, in 2012, the Supreme People's Court ("SPC") indicated a very different approach in its *Rules on Certain Issues relating to Application of Laws for Adjudicating Cases of Civil Disputes caused by Monopoly Conduct* ("SPC 2012 Rules"). Article 7 of the SPC 2012 Rules provides that, for horizontal monopoly agreements (such as cartels), the courts will presume anticompetitive effects, unless that presumption is rebutted by the defendants. The SPC 2012 Rules do not articulate whether anticompetitive effects also should be presumed for vertical agreements, but by default, when the law falls silent, "A party shall have the responsibility to provide evidence in support of its own propositions."[3]

Since then, Chinese courts have been consistently applying such an approach in civil cases involving vertical monopoly agreements. For example, in *Johnson & Johnson* (2013), Rainbow, a distributor of Johnson & Johnson, complained that the defendant had implemented vertical price restrictions and stopped supplying medical products when Rainbow bid at a lower price than required by Johnson & Johnson. The Shanghai High Court held that proof of the effect of eliminating and restricting competition was a required element of proving an illegal vertical monopoly agreement and that the plaintiff should bear the burden to prove those anticompetitive effects. In other words, rather than following the AMEAs' approach of considering anticompetitive effects to be self-evident after RPM is found, the Court instead took a "*rule of reason*" approach. After assessing (1) competitive conditions, (2) Johnson & Johnson's market position, (3) the reasons for the RPM agreement, and (4) the alleged procompetitive effects of the RPM, the Court then found that the conduct had resulted in anticompetitive effects and ruled against Johnson & Johnson.

Confrontations and Reconciliations

The courts continued to take this "rule of reason" approach in subsequent matters. In *Gree* (2016), the plaintiff, a distributor of Gree air conditioners, complained that Gree terminated the distribution agreement and imposed punishment for the plaintiff's violating minimum resale prices. The Guangzhou IP Court found that the agreement in that case did not constitute a vertical monopoly agreement because it lacked the object or effect of eliminating and restricting competition. Specifically, the Court found that (1) air conditioners are a competitive market, in which Gree is one of many manufacturers and has no substantial market share and (2) Gree's vertical restriction did not eliminate competition among Gree distributors, who can still compete on non-price aspects such as service.

Coincidentally, Haier, another well-known Chinese household appliance manufacturer, was fined by the Shanghai DRC for implementing vertical price restrictions during the same month as the Guangdong IP Court judgement in *Gree*. Because it appears that Gree and Haier face similar competitive situations—both are leading brands in their respective industries, but lack dominant market positions because of fierce competition—the juxtaposition of these two cases in 2016 made the divergence between the courts and AMEAs more apparent.

Shortly thereafter we witnessed the first judicial ruling overturning an AMEA's administrative decision. In 2016, the Hainan Provincial Price Supervision and Antimonopoly Bureau, NDRC's Hainan branch, fined Yutai, a local animal feed company, RMB 200,000 for alleged RPM agreements with its distributors. Yutai then filed an administrative lawsuit at the Haikou Intermediate Court. In mid-2017, the Haikou Court overturned the agency's decision, holding that (1) the bureau had wrongly applied the AML, as Yutai's RPM agreements did not eliminate or restrict competition due to the plaintiff's relatively low scale of operations and market share; and thus (2) the RPM conduct did not qualify as a monopoly agreement under Article 13 of the AML.

The *Yutai* case was appealed by the agency to the Hainan High Court. In its final judgement in late December 2017, the Hainan High Court generally accepted the agency's view and reversed the first instance court. The High Court held that, as far as public enforcement against illegal vertical agreement is concerned, no analysis of anticompetitive effects is required once an agreement falls under Article 14 of the AML. It noted that one key distinction between public enforcement and civil lawsuits is that, in civil lawsuits, it is necessary to prove "actual losses," which in turn are preconditioned on anticompetitive effects. On the other hand, in cases of administrative enforcement, AMEAs are not obliged to follow this approach, and are entitled to prohibit monopolistic conduct aiming to eliminate or restrict competition, even if it results in no actual anticompetitive effects.

In short, the Hainan High Court's ruling has recognized the AMEAs' approach to RPM and seems to hold that public enforcement and civil litigation may take different approaches to RPM and vertical agreements.[4] But the divergence of opinion between the AMEAs and the courts is not yet solved, and indeed it is not clear yet whether the ruling will be widely adopted by other courts across the country.

SUBTLE DIFFERENCE IN APPROACHES TO HORIZONTAL AGREEMENTS

In contrast with the approach taken in many other jurisdictions, which treat most categories of horizontal agreements among competitors as *per se* illegal,[5] the divergent approaches of Chinese courts and AMEAs appears to extend to horizontal agreements too.

Article 13 of the AML outlaws six categories of prohibited horizontal monopoly agreements, including some familiar categories (price-fixing, output restraints, market division, joint boycotts, etc.) and another catch-all provision allowing agencies to prohibit "other monopoly agreements determined by the AMEA." Article 13 also defines monopoly agreements as "agreements, decisions, or other concerted conducts that eliminate or restrict competition."

The Horizontal Enforcement Approach of AMEAs

The AMEAs' enforcement approach to horizontal agreements is, not unexpectedly, very similar to their approach to vertical agreements. In particular, the AMEAs consider that the requirement that the agreement "eliminate or restrict competition" is satisfied *per se* once parties' conduct falls into the categories listed by Article 13. Over the past decade, NDRC and SAIC, including their provincial branches, have investigated and punished dozens of horizontal monopoly agreement cases. In 2016, for example, NDRC fined three pharmaceutical companies RMB 2.6 million for engaging in price fixing and a group boycott in the supply of estazolam, and RMB 4 million against four pharmaceutical companies engaged in price fixing and market division in the Allopurinol tablets market. In 2017, NDRC handed down its heaviest-ever antitrust penalties against domestic companies as it fined 18 chemical manufacturers RMB 457 million for fixing the price of polyvinyl chloride. Similarly, in 2016, SAIC's Anhui Branch fined three companies RMB 30 million for market division in the sale of digital token-based electronic payment devices. From these cases, it is apparent that the AMEAs take a very straightforward approach toward horizontal agreements: once the agreement falls under the specifically prohibited categories of Article 13, the effect of eliminating and restricting competition is self-evident and no further effect-based analysis is required.[6]

The Approach of Chinese Courts to Horizontal Agreements

On the other hand, and in contrast to many other jurisdictions, the Chinese courts also have embraced the use of effects analysis even for cartel behavior, in some cases exempting cartels due to small market shares and lack of anticompetitive effect. According to Article 7 of the 2012 SPC Rules, when the accused conduct falls under the categories listed in Article 13 of the AML, the effect of eliminating and restricting competition is presumed, unless the defendants prove otherwise. Thus, Article 13 provides a rebuttable presumption of anticompetitive effect. In practice, the more important question is how likely and under what circumstances the defendants can rebut the presumption.

Over the past several years, there have been some cases in which the defendant has been able to rebut the presumption of anticompetitive effects. One such case is the *Shenzhen Pest Control Association* case (2012), in which the Guangdong High Court held that the Shenzhen Pest Control Association's behavior to organize member companies to set a minimum price did not violate the AML. One key fact that the Court relied on in that case was that the combined market shares of the companies involved in the agreement is relevantly small. The Court found that "there are 838 pest control companies

in Shenzhen and only 271 companies are the member of the Shenzhen Pest Control Association, among which only 187 companies were involved in the suspected agreements." Therefore, the Court held that anticompetitive effects from the conduct of the Shenzhen Pest Control Association, if any, were limited. The Court also affirmed that the association had valid reasons to justify the contract; pest control service involves toxic drug use and disinfection services that have a significant impact on local public health and environmental protection.

Furthermore, in the most recent *Brick-maker* case (2017), the Hubei High Court declared that an output limit agreement among local brickmakers did not violate the AML. Several local brick makers had reached an agreement requiring the plaintiff to retreat from the market in exchange for compensation. When other parties later refused to pay, the plaintiff brought a court action seeking enforcement of the agreement. The defendants argued that the agreement was void for violating the AML. So the key question for the Court is whether the agreement among the parties was a valid joint operation agreement or an illegal monopoly agreement. Apparently, the Court was not convinced that the agreement would eliminate or restrict competition.[7] It found that there were many major nearby brickmakers who had not entered the agreement, and that red bricks could be easily substituted by other construction materials. Therefore, the Court found that the agreement among the parties was a lawful joint operation agreement, not a horizontal monopoly agreement.

In short, accused parties in civil antitrust actions have chance to rebut the presumption of anticompetitive effect arising from horizontal agreements even if their actions fall under the scope of Article 13 of the AML, while parties in a public enforcement would find it difficult to do the same thing.

HOW CHINA WILL CONVERGE THE CONFLICTING APPROACHES

Under China's legal system, theoretically there are at least three ways to converge the AMEAs' and Chinese courts' approaches to monopoly agreements. However, in practice, the Courts appear generally to have deferred to or avoided challenging agency decisions.

First, follow-up civil actions. When AMEAs find a monopoly agreement, end-customers may use the agency penalty decisions to prove the existence of the monopoly agreement and bring damage claims in the courts. Through such civil actions, Chinese courts may apply different approaches to the effect of voiding the AMEA's decisions at least with regard to private damages claims.[8] In *Tian Junwei v. Carrefour* (2016), an infant formula purchaser filed a follow-up lawsuit against Carrefour and Abbott for vertical violation under the AML. Based on the SPC 2012 Rules, it could be expected that the court would not find the existence of an anticompetitive vertical agreement, given that Abbott's market share was not high enough. However, the Beijing High Court eventually found a way to avoid making a ruling that directly contradicted the prior AMEA penalty decision, by finding that the plaintiff did not prove there was an vertical agreement specifically between the defendants, although the agency had found generally that there were vertical agreements between Abbott and its distributors.

Second, administrative lawsuits. Article 53 of the AML allows related parties to lodge applications for administrative review or launch administrative lawsuits against AMEA and their local branches in the proper courts, when "the parties are dissatisfied with any decision made by the AMEA." In addition to the *Hainan Yutai* case, several other AMEA decisions also have been challenged in the courts, and all involving horizontal monopoly agreements. In May 2016, SAIC's Shandong Branch imposed fines against 23 accounting firms for violating the AML and implementing cartel agreements to divide the markets. One of the fined companies appealed to the Beijing Municipal City Xicheng District Court. Also, in April 2016, NDRC's Shaanxi Branch fined 31 motor vehicle inspection-service suppliers RMB 5.77 million for operating a cartel to fix and raise prices through meetings. One of the fined companies then filed a lawsuit with the Xi'an Railway Transport Court against the decision. In both cases, in the end, the courts simply supported the AMEAs' decisions without detailed anticompetitive effects analysis, making it apparent that the Chinese courts usually will defer to the AMEAs in such administrative lawsuits.

Last, legislative interpretation and rules making. Even if a court (including the SPC, China's highest court) repeals an AMEA decision through an administrative lawsuit, that may not be the end of the story. According to Article 45 of China's

Legislation Law, the Standing Committee of the National People's Congress ("NPC"), rather than the SPC, has the final authority to give interpretation to a national law, when "the specific meaning of a provision of such legislation requires further clarification." In theory, even if the Chinese courts were to repeal an AMEA decision, the AMEA can, via the State Council, request the Standing Committee to interpret the AML. In reality, formal interpretation of a law by the Standing Committee of the NPC is rare. A more likely path is informal coordination of the courts and agencies by the Standing Committee, which may be the most likely way to settle the long standing divergence here. Meanwhile, rulemaking by the AMEAs and the courts also may be a feasible way to converge their conflicting approaches. For example, it is reported that the AMEAs are making their own guidelines regarding vertical agreements. With such rulemaking process, the present issue can also be addressed. The AMEAs may embrace a more effect-centered approach, or the courts may adjust their present rule of reason approach. At last the two sides may come to a compromise.

Therefore, under China's two-track system, in the end there may still be a good chance to resolve this divergence and provide parties a more predictable, unified approach to monopoly agreements. But until then, companies operating in China should avoid potential monopoly agreements, whether horizontal or vertical, rather than relying on a defense of lack of anticompetitive effects.

ENDNOTES

1 In this regard, the AML's structure resembles that of Article 101 of the EU Treaty.

2 In some cases, AMEAs have expressed the concern of vertical non-price restrictions. The draft *Antimonopoly Guidelines in Automobile Industry* expressly provide that non-price vertical restrictions may violate Article 14 of the AML, although a safe-harbor is set for parties with relatively low market shares.

3 Article 64 of the *Civil Procedure Law*.

4 It is apparent that Hainan High Court's judgement has encouraged the AMEAs' enforcement. As a matter of fact, just two weeks after *Yutai* case, Shanghai DRC released two more penalty decisions against RPM, one involving sales by a US chemicals company, fined a total of RMB 2.37 million for engaging in RPM in sales of turbine lubricating oil in China, the other by a Shanghai electronic equipment firm , fined RMB 2.3 million for reaching RPM agreements with its dealers in the distribution headset products.

5 Except, for example, joint ventures, patent pools, and other legitimate procompetitive competitor collaborations.

6 There are some non-cartel horizontal agreements also prohibited under Article 13. Since there aren't many such cases in practice, AMEAs' approach to them is not well-developed yet.

7 Another important holding of the Hubei High Court in this case is that the anticompetitive presumption will not apply where parties to an agreement sue each other, as the presumption of Article 7 of the SPC's 2012 Rules is to protect the victims of the horizontal agreement. Therefore, the defendants, claiming the agreement was monopoly agreement, must prove the effect of eliminating or restricting competition themselves.

8 In follow-up civil actions, courts may decide on whether to accept the decisions of AMEA as an evidence, but they have no power to void such decisions in civil actions.

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