



WHITE PAPER

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China's Supreme Court Resets Resale Price Maintenance Analysis

In its first resale price maintenance (“RPM”) ruling since the passage of its Anti-Monopoly Law, China’s highest court held that Chinese antitrust enforcement agencies do not have to prove that RPM has an anticompetitive effect before issuing fines for RPM. RPM, also known as vertical price fixing, is an agreement between a manufacturer and a distributor to set the price at which a distributor will resell the manufacturer’s products to retailers. The Supreme People’s Court ruling establishes a presumption in public enforcement cases that RPM is unlawful, but companies may offer evidence to refute the presumption or argue that an exemption applies. Although the ruling provides businesses an opportunity to defend RPM in China, it offers little guidance about the circumstances in which RPM in China is lawful. Companies should therefore continue to approach RPM in China with significant caution.

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In its first antitrust ruling since the passage of China's Anti-Monopoly Law ("AML"), China's Supreme People's Court ("SPC"), its highest court, clarified rules regarding resale price maintenance ("RPM"). RPM, also known as vertical price fixing, is an agreement between a manufacturer and a distributor to set the price at which the distributor will resell the manufacturer's products to retailers. Prior to this decision, antimonopoly enforcement agencies ("AMEAs")¹ in China condemned RPM with a "prohibition + exemption" approach. RPM was per se unlawful unless an exemption applied, and AMEAs rarely conducted any analysis to determine whether RPM led to an anticompetitive result. In contrast, Chinese courts generally reviewed RPM cases under the rule of reason, which considers the net competitive impact of the conduct. The SPC's *Yutai*² ruling adopts a compromise approach for public enforcement: AMEAs may impose fines for RPM without proving that RPM led to anticompetitive effects; however, companies may avoid penalties if they can show the absence of an effect on competition. In other words, SPC set a rebuttable presumption of anticompetitive effects for RPM. The *Yutai* ruling does not alter the Shanghai Higher Court's 2013 *Johnson & Johnson* decision which held that RPM in private litigation is subject to a full rule of reason analysis in which a plaintiff must prove an anticompetitive effect.³

Although the *Yutai* decision provides companies operating in China an opportunity to defend RPM as procompetitive, courts in government-enforcement cases must presume that RPM is unlawful. Therefore, companies are still advised to avoid RPM in China.

BACKGROUND: A FOUR-YEAR FIGHT FROM INVESTIGATION TO AN SPC DECISION

The Hainan Provincial Price Bureau ("Bureau"), a local branch of the National Development and Reform Commission ("NDRC"), initiated an investigation in August 2015 regarding RPM practices among producers of fish feed following complaints from downstream fish farmers. The Bureau found that eight of 10 local fish-feed manufacturers tried to control distributors' resale prices. The agency levied administrative fines on seven of the eight manufacturers,⁴ including Yutai Feed Company, Ltd. ("Yutai").

Yutai appealed the RMB 200,000 fine (approximately USD \$29,000) to the Haikou Intermediate Court. Yutai did not dispute that it included a resale price control clause in its distribution agreements. Instead, it argued that the RPM clause did not result in the "exclusion or restriction of competition" under Article 13(2) of the AML.

Agreeing with Yutai, the Haikou Intermediate Court overturned the penalty decision, holding that RPM violates the AML only if the conduct eliminates or restricts competition. The court opined that it was not sufficient for a plaintiff merely to show that a company agreed with downstream sellers to control resale prices. Instead, an AMEA had to show that the RPM (under AML Article 14) eliminated or restricted competition (per AML Article 13(2)).

The court evaluated several factors to determine whether Yutai's RPM agreements were anticompetitive, including the scale of Yutai's operation, its share of the fish feed market, and the impact of the alleged RPM agreements on the supply and price of fish feed. This analysis was similar to the Shanghai Higher Court's 2013 *Johnson & Johnson* decision and subsequent court rulings. After evaluating the evidence, the Haikou Intermediate Court concluded that Yutai's agreements with distributors did not eliminate or restrict competition and therefore did not constitute an RPM violation.

The Bureau appealed to the Hainan Higher Court, which reversed. The Hainan Higher Court held that the AML "clearly" prohibits fixing resale prices. Further, the court held that AMEAs are not required to prove that an RPM agreement has an anticompetitive effect because such a requirement would frustrate the legislative goal of the AML. The court instead adopted the so-called "prohibition + exemption" approach advocated by AMEAs: Once an AMEA demonstrates that conduct falls within a category of conduct prohibited under AML Article 14, AMEAs may impose fines unless an exemption under AML Article 15 applies.

KEY POINTS OF THE YUTAI RULING

Yutai appealed the Hainan Higher Court ruling to the SPC, which upheld the Bureau's disputed fine and permitted AMEAs to build RPM cases on a presumption that RPM leads to anticompetitive harm.⁵

Anticompetitive Effects Presumed, but Rebuttable

Although the SPC acknowledged that an AML violation requires proof that conduct resulted in an “exclusion or restriction of competition,” it also observed that certain conduct such as price fixing, restrictions on output, or market allocations nearly always result in harm. Therefore, such conduct is condemned as per se unlawful without an inquiry into the competitive effects.⁶

The SPC acknowledged that the net effect of RPM is not easy to discern because vertical agreements can both enhance or restrict competition. However, the SPC expressed concern that markets in China are “still not fully developed.” To the extent that RPM harms competition in any given market, the SPC questioned whether “comparatively weak” market forces in China are capable of correcting anticompetitive behavior. As a result, the SPC determined that “more attention should be paid to the effect of restriction of competition of such vertical agreements.” The SPC therefore held that it would not require AMEAs to prove harm to competition in RPM cases because such a standard would chill public enforcement, consistent with the SPC’s concerns about the ability for markets to adjust in China. Going forward in public enforcement RPM cases, harm to competition is presumed under Chinese law.

However, the SPC also held that companies have an opportunity to rebut the presumption of harm, which companies can do in two ways: (i) demonstrate the agreement does not restrict competition; and/or (ii) prove that the conduct qualifies for an exemption under AML Article 15. Examples of Article 15 exemptions include improving operational efficiency; enhancing the competitiveness of small and medium enterprises; promoting various public interests such as conserving energy, protecting the environment, and providing disaster relief; mitigating severe decreases in sales or overstocking during economic recession; and protecting “the legitimate interests of international trade and foreign economic cooperation.”

The *Yutai* ruling departs from U.S. federal law, which analyzes RPM under the rule of reason. In 2007, in *Leegin Creative Products v. PSKS, Inc.*, the U.S. Supreme Court overruled nearly 100 years of precedent during which RPM was per se unlawful.⁷

Refuting the Presumption

The SPC did not provide guidance about the type of evidence that it or AMEAs will credit to rebut presumed anticompetitive

effects. However, the SPC’s decision provides some insights about facts that led to its decision. For example, the SPC noted that the eight involved feed manufacturing companies, including Yutai, accounted for 99% of the Hainan fish feed market. The SPC’s decision also was critical of the Haikou Intermediate Court’s finding that “Yutai’s scale of operation, market shares and other factors made relevant agreements less likely to exclude or restrict competition.” According to the SPC, the court’s inquiry was not sufficiently detailed. Therefore, evidence of low market shares, a competitive market structure, and small-scale operations are likely to be important to an RPM case. However, as the *Yutai* case also shows, even if one company’s share is low, it may be difficult to rebut a presumption of harm if most other marketplace participants adopt similar RPM practices.

Distinguishing Public Enforcement from Private Civil Actions

Although AMEAs need not prove anticompetitive effects, the SPC does not apply the same presumption to private litigants in civil cases. The SPC emphasized the distinction between public enforcement in which AMEAs seek to vindicate the rights of consumers and civil litigation in which private parties seek and must prove damages based on losses caused by RPM. Therefore, in private cases, plaintiffs have the burden to prove that RPM has an anticompetitive effect.

CONCLUSION

The *Yutai* ruling answers one question, but it leaves many more unanswered. The ruling clarifies that Chinese courts will presume anticompetitive effects in AMEA-led RPM cases and that companies will have an opportunity to rebut that presumption. However, the SPC provided little guidance about what evidence is sufficient to rebut the presumption or, more importantly, the circumstances under which RPM is lawful. The *Yutai* ruling leaves room for businesses to defend RPM in China as procompetitive in AMEA cases, and the presumption does not apply in private litigation. However, it also puts companies in the difficult position of proving the negative.

Although we do not expect Chinese law with respect to RPM to change in the foreseeable future, the *Yutai* decision leaves open the possibility that the SPC will revisit its decision. The SPC decision errs on the side of enforcement out of a concern

that market forces in China are not sufficiently capable of correcting competitive harm. In the future, the SPC could overturn its decision if it finds market forces more capable of correcting anticompetitive harm or its calculus changes regarding the relative ability of government enforcement and market forces to correct such failures. For now, companies should approach RPM in China with significant caution.

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ENDNOTES

- 1 Before the 2018 institutional reorganization, there were three central government agencies responsible for enforcing China's Anti-Monopoly Law: namely, the Ministry of Commerce (“MOFCOM”), the National Development and Reform Commission (“NDRC”), and the State Administration for Industry and Commerce (“SAIC”). In addition, provincial branches of NDRC and SAIC also enforced competition laws. In March 2018, the Chinese government merged AML enforcement into a single agency, the State Administration for Market Regulation (“SAMR”). For more information on the institutional reorganization, please see Jones Day's *White Paper, “Combination of China's Three Antitrust Enforcement Agencies May Bring More Aggressive Enforcement Over Long Run.”* Provincial AMEAs also retain authority to enforce the AML.
- 2 The ruling was issued on Dec. 28, 2018, but was published in late June 2019.
- 3 For a discussion of different approaches adopted by Chinese courts and AMEAs, please see Jones Day's *White Paper on “How China Deals with the Diverging Approaches to Monopoly Agreements”* and Jones Day's *Commentary on “Chinese Courts Stick to ‘Rule of Reason’ in Resale Price Maintenance Civil Actions.”*
- 4 One of the involved fish-feed manufacturers involved went bankrupt before Hainan Provincial Price Bureau completed its investigation.
- 5 Under China's litigation system, parties may apply for a retrial even when a judgment is final. This case drew the SPC's attention when Yutai applied for a retrial. Though the SPC refused to retry the case and did not fully develop its arguments on the merits, its 18-page ruling still sheds some light on the SPC's attitude to RPM and other so-called monopoly agreements.
- 6 In some circumstances, Chinese courts have permitted defendants to argue that conduct had no impact on competition, even in hard-core cartel cases.
- 7 551 U.S. 877 (2007). In certain U.S. states, RPM remains per se unlawful.

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