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Highlights from the Competition & Anti-Monopoly Law and Best Practices Conference Held by AllBright and ECUPL

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ALLBRIGHT INSIGHTS

is a news bulletin which focuses on legal developments impacting our clients doing business in the People's Republic of China.

ALLBRIGHT LAW OFFICES

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Anti-monopoly and anti-bribery enforcement efforts have increased across the board in 2013, and the risk for business operators to become embroiled in disputes and investigations is becoming increasingly apparent. These enforcement efforts are particularly focused on minimum resale pricing (retail price maintenance or “RPM”) and commercial bribery. To review the trends in judicial practice and regulatory enforcement in such areas, and to help clients better comply with the law, AllBright Law Offices and the East China University of Politics and Law (“ECUPL”) Center for Competition Law jointly sponsored a “Competition & Anti-Monopoly Law and Best Practices” conference on February 15, 2014. The conference included experts from the Shanghai High People's Court, the Price Supervision and Anti-Monopoly Bureau of Shanghai National Development and Reform Commission (“NDRC”) and the Shanghai Administration for Industry and Commerce (“Shanghai AIC”). The experts discussed and analyzed recent high-profile cases, such as the Johnson & Johnson monopoly agreement dispute, monopoly pricing cases involving Maotai, Wuliangye and infant formula manufacturers, and the GSK commercial bribery case. This Client Alert has been

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prepared to explain the key points from the experts' presentations regarding the definition of monopoly agreement, price fixing and commercial bribery, relevant judicial practice and enforcement actions.

Reviewing the Final Judgment in the Johnson & Johnson ("J&J") Case

This case arose after J&J terminated its distribution agreement with a distributor because the distributor sold suturing products below J&J's stipulated RPM. The distributor then sued J&J, alleging that the RPM clause in the distribution agreement violated the Anti-Monopoly Law ("AML"). The court of first instance ruled in favor of J&J on the basis that the distributor failed to provide any evidence that the RPM clause had any anti-competitive effects. On appeal, the Shanghai High People's Court (the "**Court**") reversed the lower court's judgment and ruled that J&J's RPM clause violated the AML. The Court judge reviewed and commented on the case in the following respects:

- *Anti-competitive effect is an essential element in the finding of monopoly agreements, both horizontal and vertical.*

The Court made it clear that the definition of monopoly agreements (agreements, decisions, or other concerted conduct that eliminates or restricts competition) under Article 13 of the AML, which introduces various vertical monopoly agreements, applies to both vertical and horizontal monopoly agreements. Therefore, a RPM clause is not illegal per se under the AML unless it has the effect of eliminating or restricting competition.

- *Plaintiff bears the burden to prove the existence of anti-competitive effect in a RPM dispute*

The Court is of the opinion that the burden of proof under Civil Procedural Law may only be

rebutted by express provisions of the laws, regulations or judicial interpretations. Since the existing laws, regulations or judicial interpretations remain silent regarding the burden of proof in a vertical monopoly agreement, the general principle applies that "the burden of proof is borne by the claimant" under the Civil Procedural Law. Therefore, the rule with respect to the burden of proof in a horizontal monopoly case (the defendant bears this burden in a horizontal monopoly case)² shall not apply to a vertical monopoly agreement. In other words, in a RPM dispute, the plaintiff bears the burden to prove the existence of the anti-competitive effects.

- *Factors to evaluate the effects of a RPM clause*

The Court decided that RPM clauses are not illegal per se, but must be evaluated to determine their effect on competition. The Court created a rule similar to the rule of reason analysis. The Court evaluated the RPM clause based on four factors: (1) the level of competition in the relevant market, (2) the defendant's market position, (3) the defendant's motives for implementing RPM,³ and (4) the effect of RPM on competition (both anti-competitive and pro-competitive effects shall be considered).

- *Method to calculate damages in an anti-monopoly case*

The Court is of the view that the damages in an anti-monopoly case shall not be calculated according to a lost profits principle under the Contract Law as it is absurd to provide RPM profits as a remedy. Instead, lost profits under Anti-monopoly Law are calculated based on normal profits in the relevant market. The

² Provisions of the Supreme People's Court on Several Issues concerning the Application of Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct ("**Anti-Monopoly Judicial Interpretation**"), Article 7.

³ According to the Court judge, this factor is not a prerequisite to determine whether a RPM clause has the effect of restricting market competition, but is rather a factor that contributes to the judge's final decision.

following are to be considered when calculating anti-monopoly profit: (1) the price difference of the product in dispute between J&J and other manufacturers, (2) the distributor's purchase discounts and taxes, and (3) the profit allocation between J&J and its distributors.

■ *Strengthened role of the expert witness*

The economic characteristics of anti-monopoly civil litigations require testimony from subject-matter experts, such as economists and accountants. The Anti-Monopoly Judicial Interpretation recognizes this necessity by allowing: (1) expert witnesses to appear before the court, and (2) the court to review and make judgments of subject-matter experts' market surveys and analysis by referring to the Civil Procedure Law and relevant judicial interpretations regarding expert conclusion.⁴ On appeal, both parties retained subject-matter experts to submit economic analyses, which influenced the Court's judgment to a certain extent. The Court judge commented that such expert witnesses will play more crucial role in future anti-monopoly cases in both fact finding and anti-monopoly economic analysis.

The Court's analysis of market dominance and RPM's economic rationality increased the legal certainty of a monopoly agreement. Scholars and legal practitioners alike praised the judgment as a milestone in China's anti-monopoly jurisprudence. We believe the judgment will function as a precedent for similar cases in the future to a certain extent. Business operators should also take notice of this judgment when employing RPM clauses.

Latest NDRC Price Fixing Enforcement Actions

■ *High-profile NDRC penalty decisions in 2013*

The NDRC is the agency in charge of enforcing price-related anti-monopoly laws in China. The NDRC and its provincial counterparts made a

series of high-profile penalty determinations in relation to price fixing in 2013, which are:

- (1) monetary penalties amounting to RMB 353 million imposed on six international manufacturers⁵ of liquid crystal display ("LCD") panels for their colluding to manipulate market prices in January, 2013;
- (2) monetary penalties amounting to RMB 449 million imposed on two well-known Chinese premium liquor manufacturers, Wuliangye and Maotai, for their RPM arrangements with distributors in February 2013.
- (3) monetary penalties totaling RMB 670 million against a group of leading infant formula suppliers⁶ for their RPM arrangements in August, 2013; and
- (4) monetary penalties amounting to RMB 500,000 against the Shanghai Gold & Jewelry Trade Association for playing a major role in the formation of a price-fixing arrangement between five major gold retailers in Shanghai in August, 2013. The five gold retailers involved received fines totaling approximately RMB 10 million.

■ *Inconsistent approaches taken by the NDRC and the Court on the matter of RPM*

The NDRC's approach to RPM enforcement appears to be much stricter than that of the Court. The Court holds the opinion that RPM

⁵ The six international LCD panel makers are Samsung and LG of Korea, and Chimei, AU Optonics, Chunghwa Picture Tubes and Hannstar of Taiwan.

⁶ NDRC investigated nine Chinese and international infant formula companies (including Wyeth, Mead Johnson, Meiji, Biostime, Beingmate, Abbott, Friesland Campina and Fonterra) and found that each of the companies had implemented RPM in violation of the AML. NDRC granted full immunity to three of the companies, Wyeth, Meiji, and Beingmate, as they voluntarily reported the violations, provided material evidence and actively remedied their wrongdoings in the course of the investigation.

⁴ Anti-Monopoly Judicial Interpretation, Articles 12 and 13.

clauses are not “per se illegal” under Article 14 of the AML, but are rather subject to something similar to the rule of reason, and the plaintiff bears the burden to prove the anti-competitive effect of the RPM. In contrast, as clarified by a NDRC official at the conference, while the NDRC does not treat RPM as per se illegal, it considers RPM to be “prohibited in principle” under Article 14 of the AML. It would therefore be up to the companies involved to prove that their RPM can be exempted under Article 15 of the AML. Under most circumstances⁷ set forth in Article 15 of the AML, in order to receive an exemption, a business operator must prove that the agreement will not severely restrict competition in the relevant market and also enables consumers to enjoy the benefits derived from the agreement.

The NDRC is thus unlikely to find RPM clauses to be AML compliant given the NDRC’s stricter approach in these investigations. To date, most NDRC enforcement actions have been against high-profile market participants which

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exert considerable market influence. However, small and medium sized participants should also be cognizant of the legal risks that RPM presents, as they too may also be subject to enforcement actions. Companies should avoid RPM requirements in any form when dealing with distributors in China.

■ *Application of AML leniency provisions*

Article 46 of the AML provides for a leniency program which can mitigate the imposition of penalties. Under the program, the AML enforcement agency can, at its discretion, abate or even eliminate penalties for participation in a monopoly agreement if the alleged violator voluntarily reports the relevant

facts regarding the monopoly agreement and provides material evidence. In both the infant formula case and the gold retailer case, the NDRC abated or eliminated penalties for companies that came forward and/or cooperated during the investigations. The NDRC’s leniency towards these companies indicates that its leniency program is available to both alleged horizontal monopoly participants and vertical monopoly RPM arrangements. This approach goes beyond the leniency regimes available only to horizontal monopoly participants in other jurisdictions.

The NDRC official speaking at the conference explained that leniency is granted depending on whether the business operator voluntarily reports themselves and whether the evidence provided is sufficiently important in assisting the investigation. The timing of the voluntary reporting is also important. Business operators should submit evidence before an investigation officially starts, or in the initial stages of the investigation (specifically, before the enforcement agency begins to collect evidence). The evidence provided by the business operator must be of key value in determining the existence of a monopoly agreement. The official further indicated that the business operator’s forthrightness (admission of possible wrongful action, proposal of remedies, i.e. price reduction) and cooperativeness during the investigation are also important factors affecting the level of penalties it may receive.

■ *Important advice to comply with the AML’s price-related monopoly provisions*

The NDRC official further shared advice on complying with the AML’s price-related monopoly provisions:

- (1) avoid resale price maintenance clauses in distributor contracts;
- (2) avoid causing distributors to sell the products at a designated price by way of

⁷ Five of the seven circumstances set forth in Article 15.

threats, intimidation or verbally warning or by other non-written communication methods;

- (3) avoid disguised resale price arrangements designed to circumvent the AML;
- (4) avoid discussing or communicating the price with competitors in any way, including by way of implication;
- (5) avoid discussing sensitive information such as price, market or turnover with competitors;
- (6) refuse requests to discuss sensitive information with competitors;
- (7) object immediately when a competitor discusses sensitive information and withdraw from the meeting;
- (8) report to the enforcement agency immediately upon discovering any AML violations in the market; and
- (9) supervise distributors to ensure they do not engage in RPM.

It is not unusual for the courts and enforcement agencies to take a different position or have different criteria on the same legal issue. However, from the business operator's perspective, the NDRC official's advice provides important guidance on complying with the law during the course of business. Undoubtedly, legal risks related to the administrative liability can be effectively reduced to the maximum by complying with the NDRC's identification standard and enforcement criteria.

New Trends in AIC Commercial Bribery Enforcement Actions

The enforcement action taken against British pharmaceutical company GlaxoSmithKline (GSK) under Chinese anti-bribery laws in 2013 highlights the compliance challenges

multinationals face in China. According to an AIC official speaking at the conference, the future trends are that: (1) much scrutiny will be placed on companies in consumer-facing industries, such as pharmaceutical, medical device, food and beverage, health-care, construction and engineering, and 4S car shops; and (2) subject to relevant provisions regarding criminal prosecution, the enforcement agency will more proactively seek the criminal prosecution of alleged violators and personal liability.

■ *Definition of commercial bribery*

Under PRC law, commercial bribery is defined as the use of **valuable** or **other means** by a business operator to bribe the transaction counterparty in order to secure the sale or purchase of goods.⁸ In order to constitute "commercial bribery", the act shall involve:

- (1) a business operator (any legal person, economic organization, non-profit organization or individual, regardless of whether it is domestic or foreign), and bribes given by employees to facilitate the sale or purchase of goods and services for the business which are attributable to the business operator;
- (2) the purpose of the activity is to facilitate the sale or purchase of goods;
- (3) the bribe shall be offered to the transaction counterparty, which could be almost any entity or individual, which is a much broader definition than similar laws in other jurisdictions such as United States, United Kingdoms and Japan;⁹ and
- (4) the bribe could be any article of value, such as "in cash or in kind, including payments under the guise of promotion, advertisement, sponsorship, grants for scientific research, service fees,

⁸ Unfair Competition Law, Article 8.

⁹ Anti-bribery laws in these jurisdictions generally limit the recipient of a commercial bribe only to public servants.

consulting fees or commissions, as well as the reimbursement of various expenses”; and “benefits other than valuables in cash and in kind,” such as expenses-paid vacations within China and overseas, etc.¹⁰

Under the PRC anti-commercial bribery law regime, the value of the bribe is irrelevant when deciding whether the activity constitutes commercial bribery. There is no minimum value threshold for launching investigations and the enforcement agency has the discretion to decide whether the payment, property or benefit offered constitutes commercial bribery regardless of its value.

■ *Exceptions to commercial bribery*

There are two exceptions to commercial bribery for payments other than the normal purchase price made to/received from the transaction counterparty. One exception is the use of trade discounts to business partners or commissions to intermediaries if such payments are properly recorded in the parties’ respective financial accounts and the intermediaries are qualified to render such services. The second exception involves advertising gifts with nominal value which are given in accordance with commercial practice. In practice, the enforcement agency determines whether a gift qualifies under this exception based on: (1) the value of the gift, (2) proportion of the gift’s value to the commodity’s value, and (3) the nature of the gift (whether the gift functions as advertisement or it is a customary business practice in the market).

■ *How to prevent a legally permissible discount from being perceived as a kickback*

Kickbacks are defined as a percentage of the commodity price given to a recipient in the form of cash, property, or other means without a clear record in the business operator’s legally

established financial records, which includes omitting account entries, shifting payments to other accounts, or forging accounts.¹¹ Although common in China, kickbacks are explicitly banned. Business operators usually find it difficult to distinguish a legally permissible discount and prohibited kickbacks in business practice, which exposes these business operators to potential administrative penalties. To prevent a legally permitted discount from being perceived as kickback, a business operator should:

- (1) define the discount expressly in a written contract;
- (2) define the method of payment for the discount expressly in the contract;
- (3) record the discount accurately in the accounting books in accordance with the statutory requirement;
- (4) make the payment to the corporate account instead of a petty cash or personal account; and
- (5) issue a proper invoice reflecting the correct and legitimate cost and expense of the discount.

It is our belief that if business operators comply with the abovementioned advice, exposure to risks related to commercial bribery in Shanghai will be greatly reduced. In practice, this advice only represents the enforcement practices of the Shanghai AIC and a trend of the whole AIC systems. The enforcement criteria will be different at different locations on a case by case basis. To conduct business in compliance with the law, it is therefore important for business operators to communicate with their local AIC office to understand local commercial bribery standards before entering into such commercial arrangements.

¹⁰ Provisions on Prohibition of Commercial Bribery, Article 2.

¹¹ Interim Provisions on Prohibiting Commercial Bribery, Article 5.

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