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Resale Price Maintenance Agreements in Distribution Agreements

This Special introduces resale price maintenance (RPM) agreements in distribution agreements between suppliers and distributors. Special attention is given to criteria of the anti-monopoly enforcement agency that determine whether a distribution agreement containing a RPM agreement is anti-competitive.

Introduction

By concluding distribution agreements with local distributors, foreign suppliers sell products or services to distributors who resell the products or services in their own names to third parties in Chinese markets. Distribution agreements may contain resale price maintenance ("RPM") agreements obligating a distributor to resell the products or services at a fixed or minimum price.

There is risk that RPM distribution agreements may violate China's Anti-Monopoly Law ("AML"). In this special we discuss the statute of RPM, the enforcement criteria that may determine RPM agreements as anti-competitive and the liabilities for violating the AML.

Resale Price Maintenance

(1) *Resale price maintenance and minimum resale price maintenance*

The AML prohibits anti-competitive agreements among trading partners (e.g. parties to a distribution agreement) which set the price of goods sold to third parties; or set a minimum price on goods sold to third parties.

(2) Maximum resale price maintenance

The AML does not directly prohibit anti-competitive agreements between trading partners which set a maximum price on goods sold to third parties. To date, the National Development and Reform Commission ("NDRC"), the anti-monopoly enforcement agency in China, has not dealt with cases of maximum price maintenance. However, it is possible that maximum price maintenance agreements violate the AML under specific circumstances, according to the NDRC.

Enforcement criteria of the NDRC

There are two methods used in international practice to determine whether RPM violates anti-monopoly law:

- the *per se rule* - RPM is treated as a per se violation of anti-monopoly law, and no further assessment is needed; and
- the *rule of reason* - when assessing alleged anti-competitive conduct of companies, further consideration of the actual effects on competition is needed.

In anti-monopoly investigations, the NDRC does not adopt the *per se rule* or the *rule of reason*. In general,

the NDRC follows a "prohibition & exemption" method in determining whether RPM agreements are anti-competitive:

- The general rule is that distribution agreements that prevent, restrict or distort competition in the Chinese markets are prohibited. In principle RPM agreements are prohibited in distribution agreements;
- In the investigation, the NDRC considers whether there are exemptions applicable to the RPM agreement as provided by law (Exemptions are discussed in the next section);
- Economic and business justifications are taken into consideration by the NDRC, but mainly when the parties under investigation put forward such justifications; and
- Companies under investigation have the right to voice their own version of the facts and can potentially be exempted from the AML's prohibition. According to the NDRC, the parties under investigation should act actively to put forward their opinion in the investigation.

Exemptions

The company under investigation for a potential AML violation has the right to request exemption from the application of the AML if the investigation involves an alleged anti-competitive agreement. The AML provides two categories of circumstances for exemptions:

- Circumstances related to domestic needs, which have two aspects, one is the economic development of China and the other one is protecting China's public interest. Under these circumstances, the parties of the alleged anti-competitive agreement need to further proof that the RPM agreement does not substantially restrict competition in the relevant market and enables the consumers to share in the benefits from the agreement; and
- Circumstances related to foreign trade, which "protect justifiable interests of foreign trade or foreign economic cooperation". The parties do not need to provide any further information.

Attitude of courts

Compared to the NDRC, the judiciary adopts a clearer rule in determining whether a RPM agreement violates the AML: the *rule of reason*. In the Johnson & Johnson case, Rainbow Technology and Trading Co., Ltd. ("Rainbow") files a lawsuit against Johnson & Johnson (Shanghai) Medical Devices Co., Ltd. and Johnson & Johnson (China) Medical Devices Co., Ltd. (collectively "Johnson & Johnson") involving a RPM agreement in the distribution agreement between parties. In the second trial judgment of 1 August 2013, the Shanghai Municipal High People's Court ("High Court") clarifies – in line with the opinion of the first trial court - that the effect of eliminating or restricting competition must be proved to determine the RPM agreement as anti-competitive. Several factors are further summarized by the High Court to analyze the anti-competitive effect of the RPM agreement: whether the company conducting RPM has a large market share; whether the conduct has an adverse effect on competition in the relevant market; and whether competition in the relevant market is sufficient. The High Court in the Johnson & Johnson case has taken advice from China's Supreme People's Court ("Supreme Court") and the High Court clarifies that in China, RPM should be analyzed in accordance with the *rule of reason*.

Liabilities

Parties to an anti-competitive agreement, such as a RPM agreement, may face administrative penalties for violating the AML. The enforcement agency can order the parties to cease and desist, confiscate illegal gains and impose a fine of 1% to 10% of sales revenue made in the previous year. In the event the anti-competitive agreement has not been implemented, a maximum fine of 500,000 RMB can be imposed. The penalties are relatively low compared to the US and EU, however, fines are rising in China. Also, penalties or fines may lead to substantial damage to a company's brand and goodwill, and bring large defense costs.

Our view

As RPM is prohibited by law and the enforcement agency is now paying more attention to RPM agreements, it is advised that suppliers avoid hard-core

RPM agreements in their distribution agreements, especially big companies with large market shares (exceeding 30%).

Suppliers can still include a recommended resale price in distribution agreements. Incorporating a recommended resale price in distribution agreements is allowed as long as the distributors' independent pricing right is respected. However, the suppliers cannot impose implicit penalties or excessive incentives when including a recommended resale price in distribution agreements. Otherwise, they risk violating the AML.

Companies being investigated by the enforcement agency are advised to actively present their version of the facts, support any statements with evidence, showing that they fulfil the criteria for exemptions and request exemption from the application of the AML.

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