Resale Price Maintenance in China – an increasingly economic question

Three recent decisions in China suggest that Resale Price Maintenance cases will not be decided solely on a legal consideration but will also turn on the economic context of the agreements in question.

Resale Price Maintenance (RPM) is a contractual commitment imposed by a supplier on its distributors not to sell its product for less (or more) than a given price. It is very common in distribution contracts throughout the world, especially in China because of the control that RPM provides over resale quality and the distribution chain.

RPM is a particularly contentious area of competition law since RPM clauses can be both beneficial and harmful to competition depending on the context in which they are implemented. For example, RPM may facilitate unlawful collusion between suppliers by allowing them to control and monitor the final retail price. RPM may also be forced on weak suppliers by strong retailers to fix retail prices, or limit retail competition in other ways. On the beneficial side, RPM can substantially increase the efficiency of the distribution chain. For example, RPM can be used by a manufacturer as a way of persuading retailers to stock a new product and invest in the product's promotion, without the risk of being later undercut by a low-price, low-service store.

The challenge for courts and administrative competition authorities is to find efficient ways to differentiate between harmful RPM and beneficial RPM. Agencies and courts in Europe and the US now use economic analysis to inform their decisions. The recent case of *Rainbow Medical Equipment* v. *Johnson & Johnson* suggests Chinese courts are heading in the same direction. While less clear from their public announcements, economic considerations also appear part of recent enforcement decisions against RPM by the National Development and Reform Commission (NDRC).

RPM agreements do not appear to be per se illegal in China. Instead, RPM will only be considered anti-competitive when it harms competition, a question which economic analysis can directly address.

Recent enforcement action in China

On 1 August 2013 the Shanghai Higher People's Court ruled that the RPM clauses in the agreement between Johnson & Johnson (J&J) and their Chinese distributor, Rainbow Medical Equipment (RME), contravened the Anti-Monopoly Law (AML) and ordered J&J to pay 530,000 RMB (roughly US$85,000) in damages to RME. This decision overturned an earlier finding by a lower court that J&J had not acted anti-competitively. The case is notable for the role that economics played in informing the Court's decision.

Specifically, the Court was clear that since RPM was defined in the law as a "monopoly agreement", it must be expected to have the impact of eliminating or restricting competition in order to be found illegal. To determine whether the agreement had the impact of eliminating or restricting competition, the Court proposed four constituent economic questions:

1. Is competition in the relevant market "sufficient"?
2. Does the defendant have a "very strong" market position?
3. What was the motive behind the RPM agreements?
4. What was the competitive effect of the RPM?

Specifically, the Court suggested that if competition in the market was sufficient then it would not have found the RPM agreement illegal. On the other hand, if the implementer of the RPM was found to have a "very strong" market position or to have anticompetitive motives, then the Court suggested the RPM agreement would probably be found illegal unless the implementer could show that the competitive effect was positive.

The Court further noted that RPM agreements are most likely to be conducive to collusion when implemented in a market where there is substantial market power. The Court concluded that "substantial market power" falls short of "dominant" and suggested that RPM implemented by firms with a market share of less than 20% would probably not be considered harmful; however firms with market share above 20% may be required to show their agreements to generate efficiency to avoid legal censure. It appears as though the existence of market power effectively shifts the evidentiary burden on to the defendant to prove that the RPM clauses do not harm competition. In the context of the specific case, the Court ruled that RME succeeded in establishing a prima facie economic case that J&J's RPM agreement was likely to be anticompetitive based on a combination of the level of competition in the market, J&J's market share and the apparent motivations behind the RPM agreements as evidenced by the language of the contract.

The Court also assessed J&J's economic arguments that their RPM clauses enhanced efficiency, but found that they had not provided sufficient evidence of a pro-competitive impact. The Court thus ruled in the plaintiff's favour. The Court did not rule out that RPM may generate efficiencies even in the context of substantial market power—indeed it gave the example of RPM agreements implemented to support the introduction of a new product, stating that these would, on the whole, be considered legal even in the presence of relatively limited competition. What is striking in this case is the extent to which it appears it was won and lost on the economic evidence introduced by each party. In many ways, this suggests that Chinese courts are adopting a standard not dissimilar to the US Supreme Court, which in the *Leegin* case ruled that the legality of RPM agreements depends on whether or not they promote economic efficiency and consumer welfare.

There have been two additional high-profile decisions by the NDRC on RPM. In February 2013 regional offices of the NDRC fined Maotai and Wuliangye, two well-known Chinese liquor companies, a total of 449m RMB (about US$72m) for having RPM agreements in place. Then on 7 August 2013, the NDRC levied fines totalling 668m RMB (about US$110m) for RPM violations of the AML by six producers of baby formula.

Administrative authorities in China, such as the NDRC, are not bound by the same burden of proof as plaintiffs in a court, and the published information about NDRC decisions is brief. However, both decisions discuss the potential for RPM to create "harm to competition". It is also likely that the NDRC prioritised both of these cases, at least in part, on the basis of their likely competitive impact. In both cases the firms had relatively strong market positions and a network of RPM agreements across the main market participants. These are important indicators in several of the main economic theories of harm covered in the literature.

While the courts and the administrative authorities appear to differ in the detail of their analysis, based on the rulings available to date, all three cases suggest it is impossible to determine if an RPM agreement infringes Chinese law solely by a legal assessment of the contract. The role of economic evidence is becoming increasingly important. In this regard the speed at which the administrative cases progressed, from initial investigation to a final decision in substantially less than six months, implies that the window of opportunity for providing economic evidence may be short, and preparation in advance may be helpful.

CRA and our experience in RPM and related cases

CRA is uniquely placed to provide the economic advice required on matters of RPM. Our experience has taught us that local expertise is highly important in the case of contentious areas such as RPM where clauses that may be deemed anticompetitive in other jurisdictions may not be so in China (and vice versa). CRA economists David Stallibrass and Elizabeth Wang both have practical experience of working with clients, courts and administrative authorities in China. The competitive impact of RPM is an active research interest of David Stallibrass.

More generally CRA's economists have recognised experience and authority in the area of pricing agreements – including Agency Agreements and Most Favoured Customer clauses (or Most Favoured Nation clauses). In Europe and the US, Agency Agreements and Most Favoured Customer clauses are increasingly under antitrust scrutiny as a potential means of bypassing RPM law. CRA experts in the US include Thomas Overstreet and Professor Fiona Scott Morton (formerly Deputy Assistant Attorney General for Economic Analysis at the US Department of Justice) who are both recognised authorities in the field of RPM and vertical agreements such as Most Favoured Nation clauses. In Europe, Matthew Bennett in the London office was Director of Economics at the UK Office of Fair Trading during the recent *Hotels* investigation into price-related vertical agreements.

Publications of CRA economists on RPM and related agreements

M. Bennett, A. Fletcher, E. Giovannetti and D. Stallibrass, "**RPM: Explaining the Controversy**". Fordham Competition Law Institute, March 2010.

E. Giovannetti, D. Stallibrass, "**Three Cases in Search of a Theory: Retail Price Maintenance in the UK**". *European Competition Journal*, December 2009.

M. Bennett, "**Online Platforms: Retailers, Genuine Agents, or None of the Above?**" *Competition Policy International*, June 2013.

S. Salop, F. Scott Morton, "**Developing an Administrable MFN Enforcement Policy**", *Antitrust*, Vol. 27, No. 2, Spring 2013.

T. Overstreet, "**Resale Price Maintenance: Economic Theories and Empirical Evidence**", Bureau of Economics Staff Report to the Federal Trade Commission, November 1983.

T. Overstreet, P. Ippolito, "**Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case against the Corning Glass Works**". *The Journal of Law and Economics*, April 1996.

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