China imposes US$117 million fine for resale price maintenance for the first time in the pharmaceutical industry

June 10, 2021

On 15 April, 2021, Yangtze River Pharmaceutical Group (YRPG) was fined RMB764 million (US$116.84 million) by the Chinese antitrust watchdog, representing 3% of its turnover in 2018, hence refreshing the record of antitrust fines in the Chinese pharmaceutical industry. It is also the first penalty of resale price maintenance (RPM) in the pharmaceutical industry, where usually cartel and dominance abuse are more common violations. It means that, while the pharmaceutical industry always remains under antitrust enforcement radar, more attention is now being paid to the distribution level of the supply chain.

The YRPG case reaffirms some important rules of public enforcement against RPM in China, for example, that illegal *per se* applies and applying for exemptions from RPM is almost impossible; and that the agreement could be written, oral or by other informal means. This case additionally illustrates when an RPM agreement would be seen as having been well implemented. In terms of legal consequences, YRPG also exemplifies when a parent company is liable for violations committed by its subsidiaries, and that a cooperative attitude during antitrust investigation matters a lot. This alert shares our observations derived from this interesting case.

I. Key Insights on RPM

The investigation was launched upon a report in November 2019 by the State Administration for Market Regulation (SAMR), who later found that YRPG entered into RPM agreements with downstream companies on five drugs in mainland China from 2015 to 2019, therefore violated Article 14 of the Chinese Anti-monopoly Law (AML) for reaching and implementing vertical monopoly agreement. In the announcement, SAMR clarified several key points regarding the determination of RPM practices as follows:

"Prohibition in Principle with Exceptions for Exemptions"

In China, a dichotomy has long been maintained between public enforcement authorities and courts as regards the RPM determination. In short, courts apply the rule of reason when hearing civil disputes over RPM and require a plaintiff to prove that a defendant's conduct has indeed excluded or restricted competition, whereas public enforcement authorities take another approach coined "prohibition in principle with exceptions for exemption" (" 原则禁止加例外豁免" in Chinese) , equivalent to the per se illegal approach in the determination of RPM cases. After the Supreme People's Court has explicitly stated its stance in the Hainan Yutai case that courts would not interfere with administrative enforcement, SAMR now quotes support from the Expert Advisory Group of the Anti-monopoly Commission of the State Council and reiterates that the *per se* illegal approach will continue to be the norm in the public enforcement of RPM cases.

Substance over the Form

Monopoly agreement may sometimes take the forms other than written agreement. Such is the case for YRPG, as

SAMR found that in addition to written forms such as cooperation agreements and issuance of price adjustment letters, YRPG also adopted oral notification to implement RPM, including telephone notification, WeChat (a popular messaging and social media app) notification, direct door-to-door notification, etc. According to Article 5 of the Provisional Provisions on the Prohibition of Monopoly Agreements, an agreement or decision may be in written or oral form. Therefore, this case reaffirms the principle that it is the substance rather than the form that determines the nature of a monopoly agreement.

Drawing Lines between the Conclusion and Implementation of RPM

Companies that enter but fail to implement a monopoly agreement are subject to a fine up to RMB500,000 (US$77,000), whereas companies that enter and successfully implement a monopoly agreement may face a fine of 1% to 10% of its total turnover in the previous year. Seeking to minimize the penalty, YRPG argued that the agreement was not strictly implemented. Nevertheless, SAMR concluded that setting the penalty measures (of breaching the RPM agreement, such as withholding bonus or cutting supply) itself had sufficient deterrent effect and need not to be actually carried out to guarantee the implementation. That is, the actual effect of setting penalty measures proves that it is a sufficient deterrent, so that the monopoly agreement can be proved to have been well implemented.

Applying for Exemptions: De Facto Unavailable

According to “prohibition in principle with exceptions for exemption”, it is possible that investigated companies could try to apply for exemptions from RPM under Article 15 of the AML. But in fact, so far there has been no such case in which an exemption under Article 15 is successful. YRPG also filed application for exemptions based on circumstances stipulated in Article 15(1)(a) and (d) of the AML. However, SAMR found that relevant circumstances are not met and YRPG also failed to prove that the corresponding behavior would not seriously restrict competition in the relevant market and would enable consumers to share the resulting benefits, therefore rejected the raised application.

II. Parental Liabilities for Antitrust Violation: Gauging Potential Legal Exposure

Considering that SAMR is adopting a “full-caliber” approach in calculating the base of fines, i.e. the “turnover of the previous year” as the base of fines not only include turnover of products involved in the monopolistic act, but cover all products’ turnover of the party involved, thus whether the subject of the penalty is the parent company or the subsidiary will make significant difference for the total fine.

Unfortunately, in the present case, SAMR identified the parent company YRPG as the violator of the law, since YRPG was found to be the decision maker, implementer and supervisor in the conclusion and implementation of the monopoly agreement, whereas its subsidiaries only followed its deployment. In particular, the fact that YRPG’s legal representative is simultaneously the director of the pricing committee and the legal representative of the drug production and sales subsidiaries also illustrates the subordinate nature of subsidiaries.

To learn from this lesson, a firewall beforehand may prove to be necessary for companies seeking for minimal legal exposure. It should enable the parent company to effectively demonstrate that it does not play any role in the subsidiary’s AML violation.

III. Risks of Vertical Non-price Restraint Staying

Low for the Time Being

In addition to RPM, according to the announcement YRPG also imposed vertical non-price restraint on distributors – requiring territorial allocation and prohibiting them from cross-supply. It could have constituted a vertical non-price monopoly agreement other than RPM. However, SAMR only identified it as a measure to ensure the implementation of RPM and did not separately find it violate Article 14 of the AML.

This approach is consistent with what the antitrust enforcement agencies had adopted before the establishment of SAMR in 2018. Prior to the institutional reform of antitrust enforcement agencies, the NDRC (National Development and Reform Commission) system was responsible for investigating and dealing with price-related monopolistic acts, while the SAIC (State Administration for Industry and Commerce) system was responsible for investigating and dealing with monopolistic acts that do not involve prices. Therefore, NDRC and its local agencies had no authority to make determinations on vertical non-price restraints when enforcing against RPM practices.

Today, however, SAMR has merged their enforcement authority and has no obvious obstacle to enforce against vertical non-price restraint together with RPM. The fact that SAMR still follows NDRC's approach might be interpreted as that SAMR has not yet included vertical non-price restraint in its enforcement priorities.

IV. How to Cope with Investigation: to Cooperate or Not to Cooperate

It has been repeatedly proved by the Chinese antitrust enforcement practices that cooperation is the best strategy for companies facing an antitrust investigation. For example, in the calcium gluconate API monopoly case (2020), heft fines were paid for refusal to cooperation. In the present case, YRPG was uncooperative at the beginning of the investigation and then softened its attitude as the investigation progressed.

Six months after SAMR initiated the investigation, YRPG had twice applied for commitment, both were rejected by SAMR. According to commitment procedure, companies suspected of RPM may apply for suspension of investigation and undertake to take specific measures to eliminate the effects of their acts within specified time period, as previously in the Haichang contact lens case (2019) and the Lenovo case (2020), where successful suspensions were both applied and corresponding penalty were waived as a result. However, the application should be made as early as possible, since such application will no longer be accepted once the enforcement authority has verified the constitution of monopoly agreement. It is also possible that YRPG's noncooperation at the beginning has affected its application for commitment.

V. Conclusion

This case also shows that SAMR is developing and improving its capacities to perform its antitrust enforcement duties. SAMR entrusted a total of 27 provincial market supervision departments to carry out extensive investigation on the implementation of the monopoly agreement, and it also solicited comments from Expert Advisory Group of the Anti-monopoly Commission of the State Council on key legal issues.

Besides, although the pharmaceutical industry has long been the focus of antitrust enforcement, previous enforcement has mostly focused on the field of APIs (active pharmaceutical ingredients), and the acts involved were mainly horizontal monopoly agreements and abuse of dominant market position. It is the first time that a vertical monopoly agreement in the pharmaceutical industry has been investigated and punished in China, which means it could become the focus of enforcement in the future. Therefore, we advise relevant pharma companies to pay extra attention to their compliance in distribution management and to watch out for enforcement trends in this area closely.

Your Key Contacts

Jet (Zhisong) Deng
Senior Partner, Beijing
D +86 10 5813 7038
M +86 135 2133 7332
zhisong.deng@dentons.cn

Ken (Jianmin) Dai
Partner, Shanghai
D +86 21 5878 1965
M +86 139 1611 3437
jianmin.dai@dentons.cn