

ACI seminar on China Antitrust

Distribution arrangements under the Anti-Monopoly Law

Outline for panel discussion



Overview

- > 1. Legal framework for distribution issues
- > 2. Focus on resale price maintenance
- > 3. Other supply chain issues
- > 4. Effective compliance programme

Legal framework for distribution issues under the PRC Anti-Monopoly Law (AML)

- > **Horizontal monopoly agreements (Article 13):** Price-fixing, market/customer allocation, output restriction, joint boycotting, etc.
- > **Vertical monopoly agreements (Article 14):**
 - > Only **resale price maintenance (RPM)** is specifically prohibited
 - > **Other vertical restrictions** can also be caught by catch-all provisions of Article 14 if adverse effects on competition outweigh efficiencies (so-called “rule of reason” approach)
 - > No guidance to-date as to the scope of these catch-all provisions
- > **Abuse of market dominance (Article 17):** Excessive pricing, predatory pricing, refusal to deal, exclusive dealing, tying, discriminatory treatment, etc.

RPM in various forms

> RPM can take various forms including (NDRC also has pointed to these implementation mechanisms):

Setting the resale price formula or price range formula

Linking the resale price to the resale price of competitors or other downstream distributors

Linking restrictions on sales into unauthorised territories to the resale price

Fixing the maximum discount offered by/ distribution margin for downstream distributors

Setting the minimum distribution margin for downstream distributors

Fixing the minimum operating profit/tax burden ratio for downstream distributors

Distinguish between RPM and genuine maximum and recommended resale prices

- > **Non-binding maximum and recommended resale prices** to distributors are lawful
- > **De facto RPM** (i.e. RPM in disguised forms) is essentially reducing incentives on buyer to lower price:
 - > Offering economic incentives or imposing pressure requiring retailers/distributors to sell at the recommended resale price
 - > Punishing retailers/distributors who do not comply with the recommended price (e.g. stop supplying, delay orders, higher charge or less discount/rebate)
 - > Maintaining monitoring mechanisms which may lead to "enforcement"

Other supply chain issues – exclusivity/non-compete arrangements

Although no express prohibition in China, authorities likely to look to EU model for guidance:

- > Principal concern is foreclosure of competing suppliers/buyers. Any adverse effect on competition weighed against efficiencies
- > Exclusive distribution/supply usually only gives rise to possible concerns if one or more parties has market power (e.g. market share above 30%)
- > Non-compete terms should generally not exceed five years (unless longer period justified by specific circumstances)
- > Note, more caution required where company is in a dominant position

Other supply chain issues – excessive pricing

- > Recent enforcement initiatives against excessive pricing, e.g. recent record fine on **Qualcomm**, suspended probe into **InterDigital**, reported ongoing investigation into **HDMI**
- > NDRC's implementing regulation provides some guidance, i.e. to consider:
 - > whether the price is noticeably higher than that for goods of the same kind
 - > whether the price increases excessively while the cost is largely stable
 - > whether an increase in price is noticeably higher than the cost increase
- > Questions remains, e.g.
 - > To what extent can the price in China deviate from that in other countries?
 - > If patents are involved, to the extent would NDRC expect the price for the previously-patented products to decrease after the expiry of the patent(s)?

Other supply chain issues

- > **Hub-and-spoke**: distributors compete with each other at the same level of supply and supplier must not act as a coordinator between them
- > **Territorial/customer restrictions**: supplier restricts territories and customers to which distributor resells
- > **Coordination/information exchange**: where distributors compete with supplier for the same customers
- > **Selective distribution arrangements**: supplier restricts sales to distributors on basis of certain specified criteria which may also affect on-sales by the distributor
- > **Tying**: buyer required to purchase “tied” product/service as condition of purchasing “tying” product/service

Distribution compliance programme

- > **Conduct internal audits**, e.g. review distribution agreements and update competition compliance policies
- > **Improve competition law awareness**, e.g. train sales/marketing teams, prepare/update company's "competition dawn raid protocol"
- > No global one-size-fits-all solution – need to customise the global programme to reflect the Chinese laws and enforcement practices

Compliance across the region -- RPM in Asia-Pacific

Business practice	Australia	China	Hong Kong	India	Indonesia	Japan	Malaysia	New Zealand	Singapore	South Korea	Taiwan	Thailand	Vietnam
Setting maximum resale prices	✓	✓	?	✓	✓	X	Effects-based	X	✓	Effects-based	X	?	?
Setting minimum resale prices	X	X	?	?	Effects-based	X	Effects-based	X	✓	X	X	?	X

- ✓ permitted (regardless of market power)
- X not permitted (regardless of market power)
- Effect s-based dependent on whether the arrangement has the purpose or likely effect of substantially lessening competition
- ? law is currently unclear on whether it is permitted or not

Questions?



Linklaters