

Vertical Restraints of Chinese Anti-monopoly Law



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I. General methods to analyze monopoly agreements



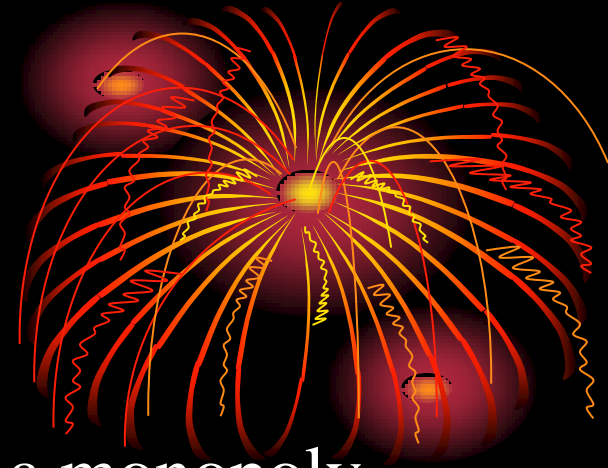
- The standard for legitimacy is to balance the positive and negative effects
- Reflected to be "generally prohibited" + "widely exempted"
- - "Prohibition" is meaningful only in jurisdiction, and is not prohibition in substantive laws
- - Exemption is one of the basic steps in the analysis of antimonopoly law, and is not an exception

Article 13 Operators of a competitive relationship shall not enter into a monopoly agreement:

- (1) to fix or change commodity prices;
(2) to limit the quantity of production or sales of commodities;
(3) to divide the sales market or raw materials procurement market;
(4) to limit the purchase of new technologies or new equipment, or limit the development of new technologies or new products;

.....





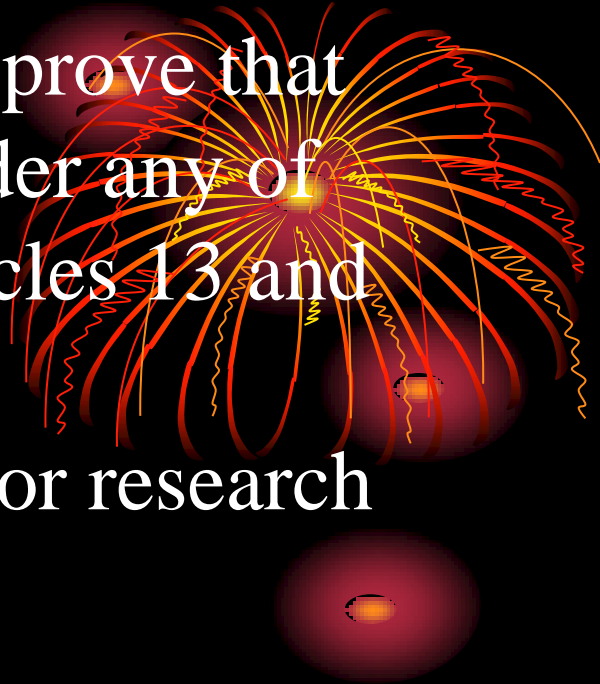
- Article 14 Operators shall not reach a monopoly agreement with any counterparties:
 - (1) to fix the price of commodities resold to any third party;
 - (2) to limit the lowest price of commodities resold to any third party; and
 - (3) any other monopoly agreement confirmed by the Anti-monopoly Law Enforcement Agency under the State Council.

Article 15 If operators are able to prove that the agreements concluded fall under any of the following circumstances, Articles 13 and 14 of this Law shall not apply:

- (1) To improve technologies or research and develop new products;

.....

- With regard to circumstances in Items (1) to (5) of the preceding paragraph, if Articles 13 and 14 of this Law are not applicable thereto, operators shall also prove that the agreements concluded would not severely limit competition in the relevant market may enable consumers to share the interests

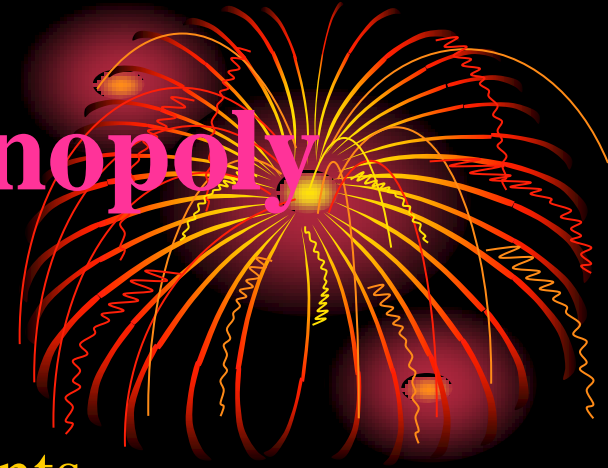


Divided into two analysis steps

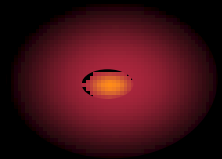
- 1. Confirmation of the monopoly agreement
 - (1) Confirmation of the agreement; and (2) Confirmation of monopoly.
 - Considering the negative effects of the agreement
- 2. Comparing the positive and negative effects
 - Reflected in the exemption system
 - Considering the positive effects of the agreement and whether the limitations and efficiency are commensurate



II. Confirmation of Monopoly Agreement



- (1) Overview of monopoly agreements
- In accordance with Article 13.2 of the Anti-monopoly Law: For the purposes of this Law, monopoly agreements refer to agreements, decisions, or other concerted practices that exclude or limit competition.
- The ultimate goal of a monopoly agreement is to enhance the price, which will lead to a reduction in the total output of the community.



Therefore, the standard for a monopoly agreement is: It is likely to reduce the total output of the society



- This imposes higher requirements for the plaintiff in terms of evidence, which helps to achieve balance of the burden of proof of the plaintiff and the defendant.
- The defendant has two defenses
- - If "exclusion or restriction" is equivalent to a "monopoly agreement", many efficient acts will be hindered

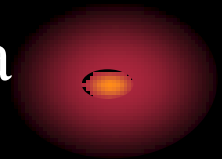
(2) horizontal proof of a monopoly agreement



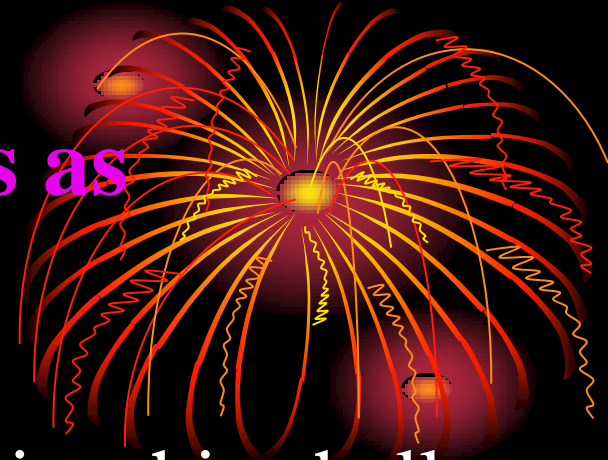
- It is the competition between brands that restricts the potential price rises
- The main difficulty lies in the proof of an "Agreement"
- The word "monopoly" is relatively easy to prove:
 - - It directly weakens the competition between competitors, which may reduce the social total output in theory
 - - Its actual risks depend on the combined market power of the parties and the nature of their acts

About nature

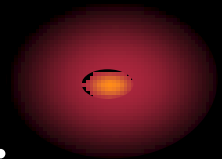
- Article 7 of the "Provisions on Certain Issues Concerning the Application of Laws in the Trial of Civil Disputes due to Monopoly"
- "Where the alledged monopoly act is under a monopoly agreement as specified by Article 13.1(1) to 5 of the Anti-Monopoly Law, the defendant is not obligated to prove that such act has the effect of eliminating or restricting competition."
- - The five categories of agreements have serious limiting effects, and are construed as monopoly agreements.

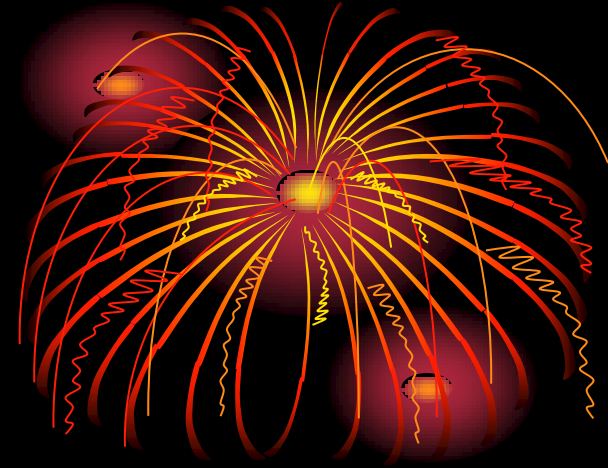


The five types of agreements as specified in Article 13.1



- Operators of a competitive relationship shall not enter into a monopoly agreement:
 - (1) to fix or change commodity prices;
 - (2) to limit the quantity of production or sales of commodities;
 - (3) to divide the sales market or raw materials procurement market;



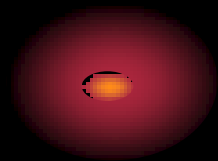


- (4) to limit the purchase of new technologies or new equipment, or limit the development of new technologies or new products;
- (5) to boycott transactions; and
- (6) Other monopoly agreements as determined by the anti-monopoly law enforcement agency of the State Council.

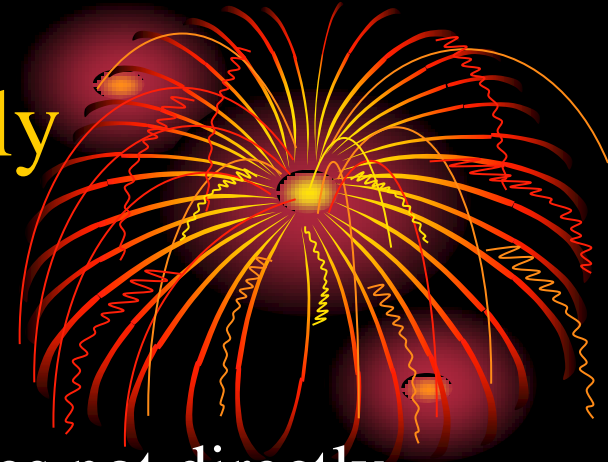
Other types of horizontal agreements shall be proved by the plaintiff:



- - "Eliminate or restrict competition."
- With a view to limit competition
- Or results in (or is likely to result in) such effects
- - Such "elimination or restriction" is likely to result in decrease in the total output of the community. So the main task is to measure the combined market power of the parties.
- Balance of the burden of proof between the plaintiff and the defendant



(3) Proof of Vertical Monopoly Agreements



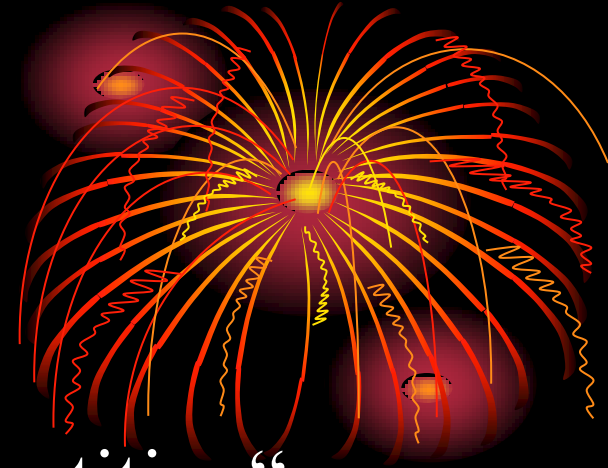
- The internal competition of a brand does not directly impede the ability of other brands to rise in price
- As long as the competition between brands is normal, limiting the internal competition of a brand does not enhance the ability of the parties to raise prices, and is not likely to "reduce the total output of community".
- - It is necessary to prove that it is likely to reduce the total output of the community in order to prove that vertical agreement constitute monopoly agreement.

1. The main negative effects of vertical restrictions

- Inadequate competition between brands
 - (1) It is likely to strengthen market forces of the parties, resulting in the exclusion of its competitors or increase in the prices to the counterparties to achieve the purpose of exploitation
 - The suppliers control the vendors to exclude other suppliers, and heightens the market barriers to impede the entry of potential competitors
 - (2) Competing operators are likely to achieve horizontal coordination by means of a vertical agreement
 - - In short, it may serve the abuse of the dominant position, or serve the horizontal monopoly agreement
 - - Both cases are likely to result in decrease in the total output of the community, thus constituting monopoly agreements

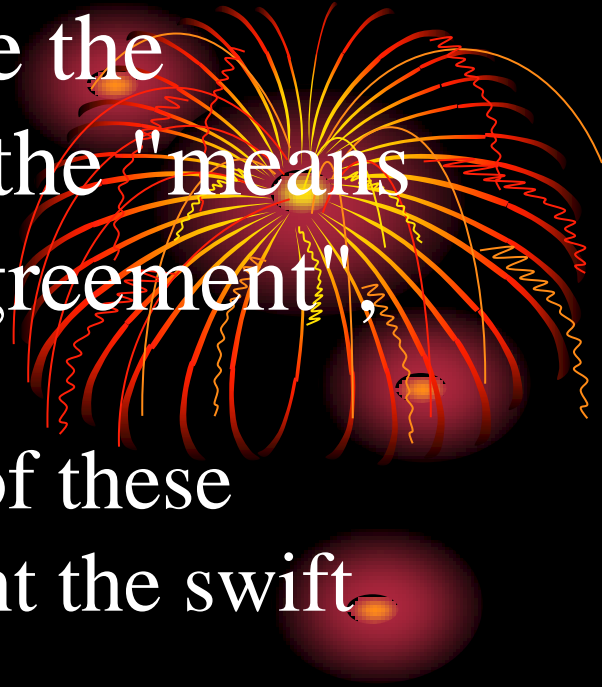


2. Proof of "monopoly"



- - To Eliminate or Restrict Competition“
- - The conditions to "serve the abuse of the dominant position, or serve the horizontal monopoly agreement"
- Namely
- (1) The person performing such act has a dominant position, or

(2) The vertical restraints have the fundamental conditions to be the "means of the horizontal monopoly agreement", and



- The combined market power of these competitors is enough to prevent the swift of the consumer demands
- - Whether there is a competitive relationship between the parties
- - Distinguish between one-way and two-way agreements

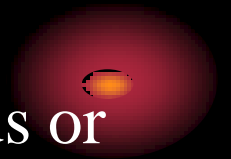
III. The standard to determine the validity of a monopoly agreement



- (1) Article 1 of the Sherman Act of the United States
- "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony [. . .]"
- + Violations "per se" and violations of the "rule of reason"

(2) Article 101 (3) of the "Treaty on the Functioning of the European Union"

- The provisions of paragraph 1 may, however, be declared inapplicable in the case of: (an agreement restricting competition) ... which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.



(3) Article 15 of the "Anti-monopoly Law of the PRC"

- If operators are able to prove that the agreements concluded fall under any of the following circumstances, Articles 13 and 14 of this Law shall not apply:
 - (1) To improve technologies or research and develop new products;
 - (2) To enhance product quality, decrease cost, increase efficiency, unify product specification, standard, or implement division of work based on specialization;
 - (3) To increase operational efficiency of medium and small operators and enhance their competitiveness;
 - (4) To save energy, protect environment, assist in disaster relief work, or realize other social public interest;



(5) To relieve severe decrease of sales or apparent overproduction during times of economic depression;

- (6) To protect legitimate interests in foreign trade and foreign economic cooperation; and

(7) Other circumstances specified by the law or the State Council.

- With regard to circumstances in Items (1) to (5) of the preceding paragraph, if Articles 13 and 14 of this Law are not applicable thereto, operators shall also prove that the agreements concluded would not severely limit competition in the relevant market may enable consumers to share the interests resulted therefrom.



(3) Exemption of Vertical Monopoly Agreements

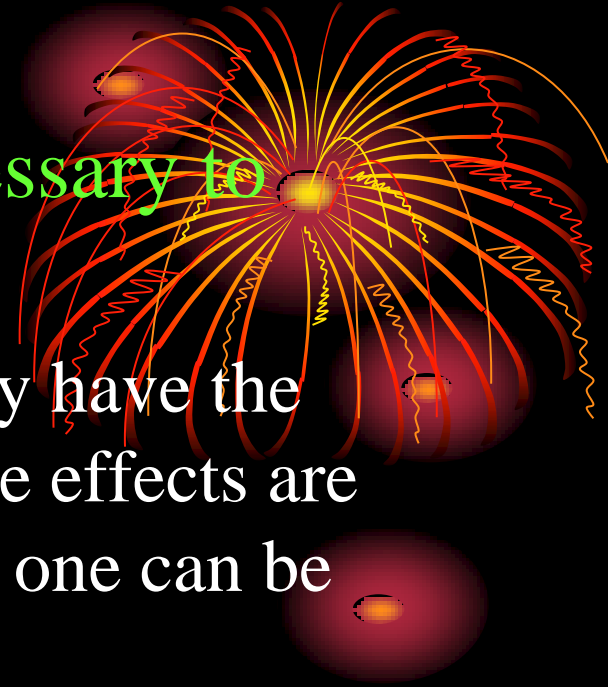


- 1. Efficiency That May Result from the Agreement
 - (1) Solve the problem of "free ride"
 - (2) Solve the problem of "hold-up"
 - (3) Is conducive to maintaining the quality of the products and the unified mode of operation
- 2. Consumers will reap a fair share

3. The restriction imposed is necessary to achieve efficiency

- (1) Different vertical restrictions may have the same positive effects, but its negative effects are different. So only the less restrictive one can be selected.
- (2) When different vertical restrictions are combined together, they sometimes reinforce each other, and sometimes offset each other. So the analysis must be on a case by case basis.

4. Not to eliminate competition



IV. To Maintain Resale Price

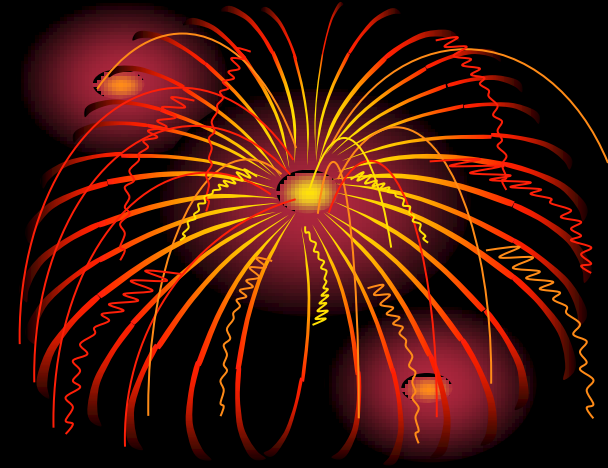
- (2) Proof of a "monopoly" agreement
- The maintenance of resale price mainly has three kinds of negative effects, and must satisfy one of the "possibilities" to constitute a monopoly agreement.
- 1. Function as the tool of the dominant retailer to block market
- (1) The manufacturer's product must have a dominant position
- (2) The retailer also has a dominant position in the retail market



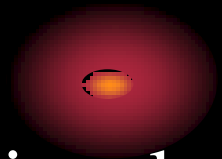
- 2. Functions as the tool of the retailer cartel, which also must be proved
- (1) The manufacturer's product has a dominant position
- - Retailer cartel
- 3. Function as the tool of the producer cartel
- - Two or more manufacturers maintain the resale prices at the same time
- - These manufacturers together have the power to prevent the shift of consumer demands



(2) Exemption



- 1. Efficiency
- Prevent free ride in order to encourage retailers to provide pre-sale and promotional services for the products of manufacturers
- Is conducive to increase in total output and stimulating competition between brands
- 2. Consumers will reap a fair share



3. Essential restrictions

- An exclusive sales agreement may also prevent free ride, but is applicable to different products
- The two generally should not be used together, as one of them is sufficient to solve the problem of free ride, while the other is "not essential restriction"
- 4. Not to eliminate competition
- Increase in prices does not exclude other manufacturers



(3) The Cases of Moutai and Wuliangye

- 1. Facts
- On February 22, 2013, the Sichuan Provincial Development and Reform Commission fined the Wuliangye Yibin Co., Ltd. RMB 202 million for vertical price restraints.
- "... violated Article 14 of the "Anti-monopoly Law", eliminated and limited market competition, and damaged the interests of the consumers". The anti-competitive effects: (1) eliminated the competition between the various distributors in the same brand;



(2) Limited competition between different brands in the liquor industry,



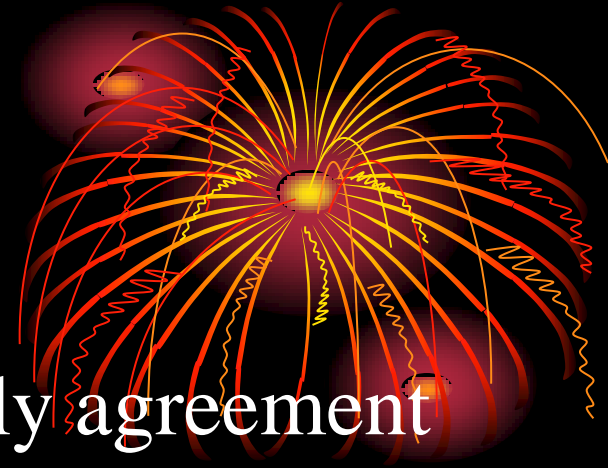
- As a leading enterprise in the industry, the acts of Wuliangye Yibin Co., Ltd. has certain exemplary role to other competitors, and will lead to more serious damage and anti-competitive effects;
- (3) Damaged the interests of the consumers. Taking into account the important position of Wuliangye in the flavor liquor market in China, the substitutability of its products is low, so it deprived consumers of the opportunity to buy goods at lower prices."

2. Analysis of way to handle the case

- (1) On the cognizance of "monopoly"
- Simply based on vertical restraints, not taking into account the effect of transverse restraints
- (2) On the cognizance of illegal acts
- Determined to be illegal directly based on the "restriction of the internal competition of a brand" without considering Article 15 of the "Anti-monopoly Law".



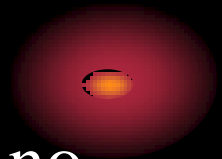
3. Proposed approach

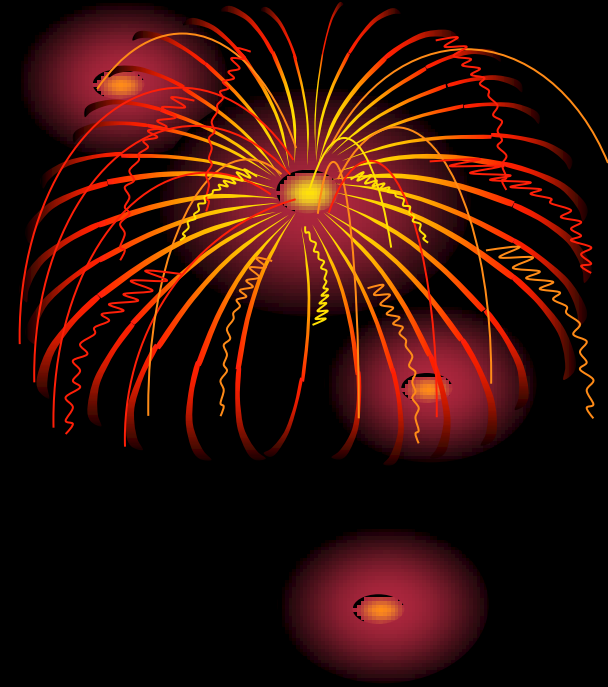


- 1. Confirmation of the monopoly agreement
- In the high-end liquor market
 - - Two operators were maintaining the resale prices
 - - Their combined market power is sufficient to prevent the swift of the consumer demands
 - - Therefore it constituted a "monopoly" agreement

(2) The application of exemption

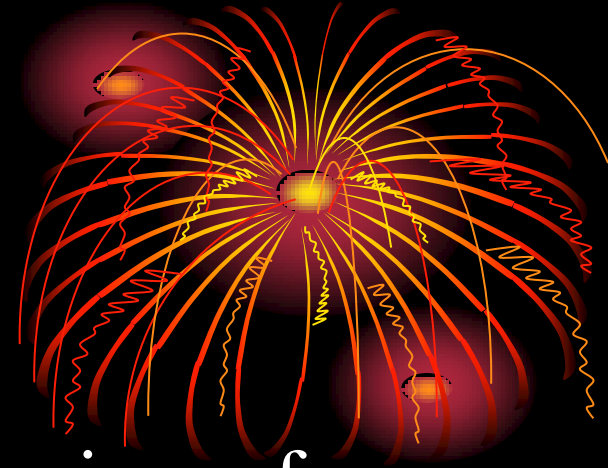
- Pre-sale services are not required in the sales of liquor
- The two kinds of liquor did not involve the problem to enter new markets, and there was no proof that retailers paid promotional costs.
- Therefore, there was no need to prevent free ride
- So it was unable to produce efficiency, and did not comply with the first condition for exemption





(4) The milk powder case

Reason:



- "... had the effects of fixing the prices of resold commodities or limiting the lowest prices of resold commodities, reached and implemented an agreement to monopolize the sales price of milk powder, which violated the provisions of Article 14 of the "Anti-monopoly Law" and maintained high sales price of milk powder unlawfully, -
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- Seriously eliminated and limited price competition of the same milk powder brand, weakened price competition between different milk powder brands, destructed fair and orderly market competition order, and damaged the interests of the consumers".
- And it couldn't prove that "its acts to control price were in compliance with the conditions for exemption as specified by Article 15 of the 'Anti-monopoly Law'".

(5) The case of FAW-VW's fixation of resale prices



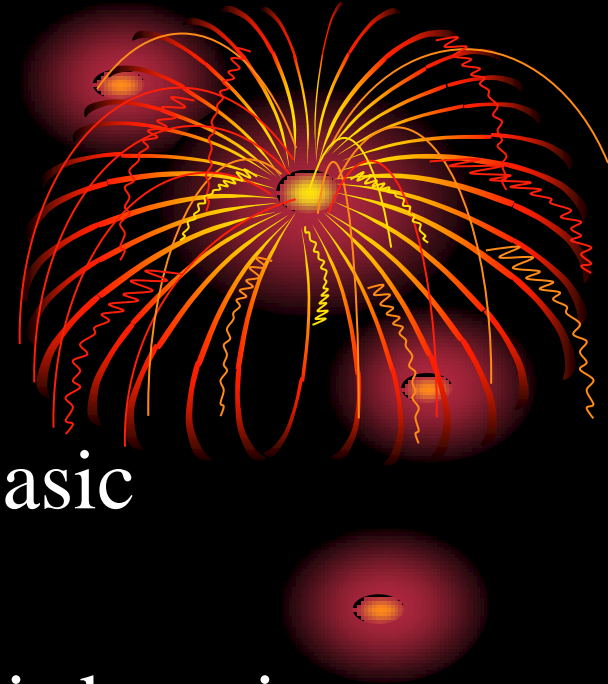
- Since 2012, the Audi Sales Division under FAW-VW Sales Co., Ltd has organized 10 Audi dealers for many a time to reach and implement monopoly agreements to monopolize the prices of vehicle sales and service maintenance.
- In September 2014,, Hubei Provincial Development and Reform Commission fined FAW-VW and its distributors.

The DRC Anti-monopoly Bureau believes that



- "Its purpose was to control the distributors' prices of resale to third parties and the after-sales service prices, which deprived and intervened the pricing rights of downstream operators, raised the sales prices of vehicles and spare parts, eliminated and limited the normal competition order of the vehicle and spare parts market, and damaged the equity of the consumers", which violated Article 14 of the "Anti-monopoly Law".
- So it was confirmed to be illegal.

V.Exclusive distribution agreement



- Usually contains two types of basic restrictions:
 - - The supplier can't supply to third parties within the prescribed scope
 - - All exclusive distributors may only sell within the prescribed scope, and may not engage in "voluntary sales" in exclusive scope of others

(1) Confirmation of the monopoly agreement



- The potential negative effects of an exclusive sales agreement
 - - Reducing the number of distributors
 - - All exclusive distributors may not operate outside the business scope, further weakening the intensity of internal competition of a brand
- But if the competition between brands is sufficient, the total output of the community will not be reduced

Therefore, it is necessary first to prove that the doer has market power



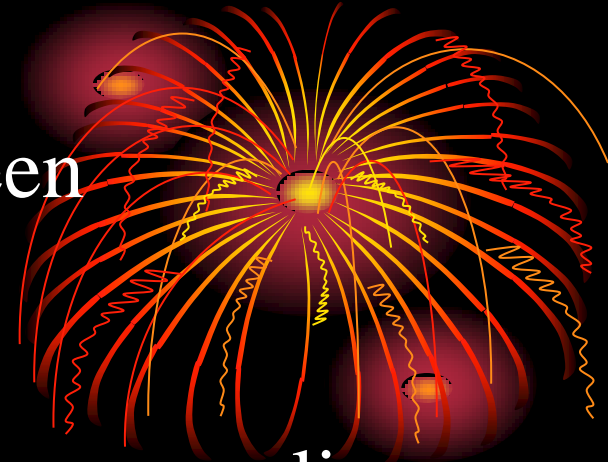
- 1. If the supplier has strong market power in the upstream, its exclusive distributors will have the ability to increase the prices, which will constitute a monopoly agreement.
- - Other retailers cannot provide such products, while the products of other brands are not sufficient to meet consumer demands

But this is contrary to the interests of the suppliers, so they may be forced by retailers.



- Therefore, it is necessary to investigate the market power of both parties, especially the market power of the buyer
- Exclusive sales may improve the market power of distributors, especially that of large national retailers, or obtain exclusive sales agreements of many key suppliers
- Whether the agreement is in the wholesale stage or retail stage

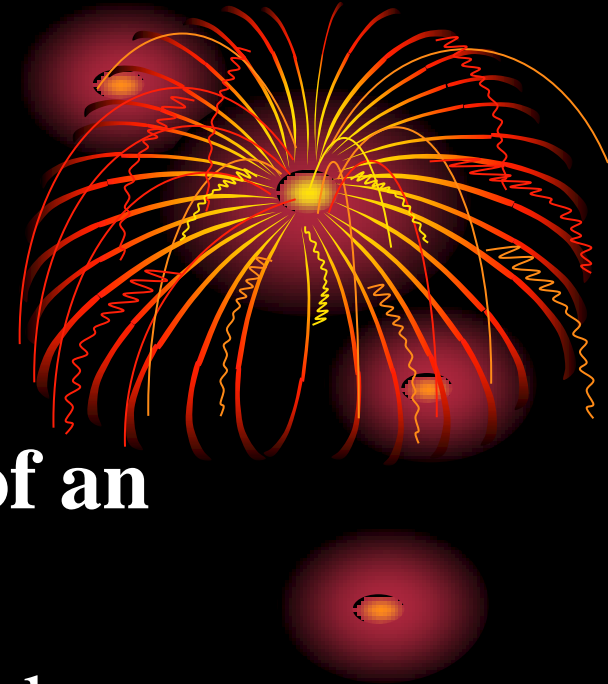
2. Facilitating coordination between competitors



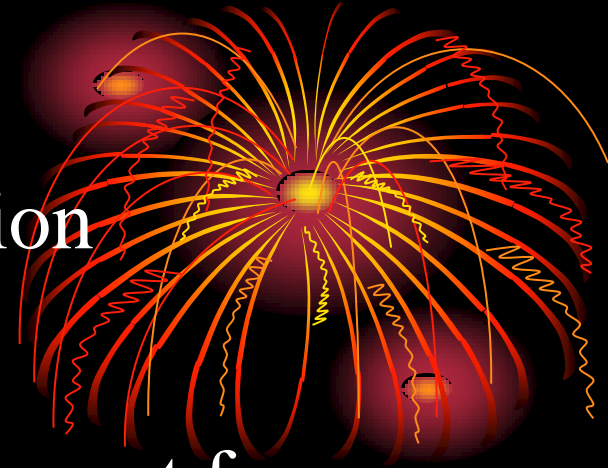
- Several distributors force the same supplier to accept exclusive sales agreement at the same time, which is highly likely that these distributors are concluding an agreement to divide market
- These distributors together must have dominant market power to be able to force manufacturers to accept the above conditions.

(2) Exemption

- **1. The potential efficiency of an exclusive sales agreement**
- (1) To prevent "free ride", and encourage distributors to promote and provide pre-sale services
- (2) To prevent "hold-up"
- 2. Consumers sharing

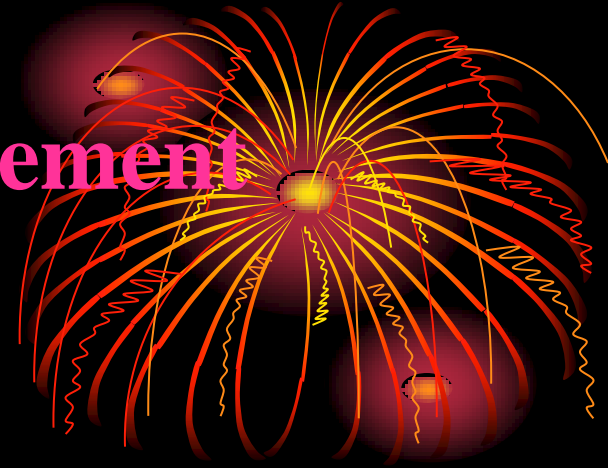


3. Not to seriously limit competition



- (1) When used as a means to prevent free ride, it should generally not also be used to maintain resale prices
- (2) When used to prevent hold-up, an exclusive sales agreement is not "a restriction necessary to achieve efficiency" if it is only necessary to impose quantitative restrictions.
- (3) "Passive sales" shall not be prohibited

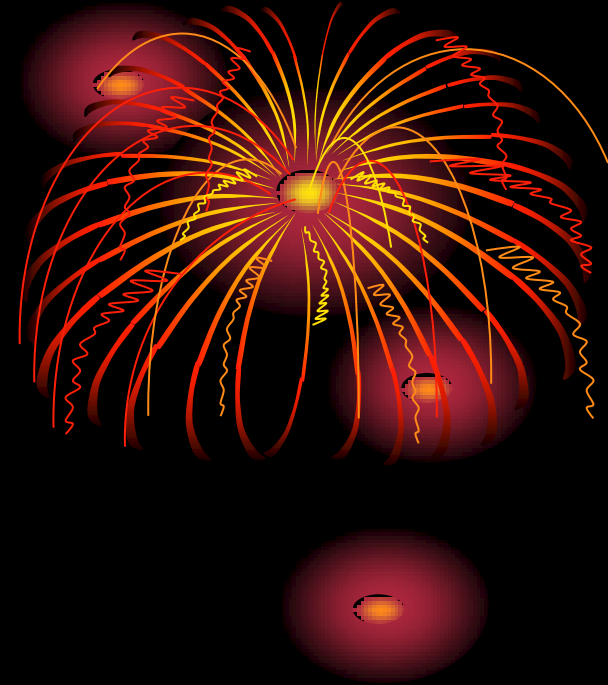
VI. Exclusive purchase agreement



- (2) Proof of a monopoly agreement
- 1. Negative effects:
 - - Excluding other suppliers, directly limiting competition between brands, and different from most of the vertical agreements
 - - Weakening competition between suppliers, and stabilizing their relationship
 - - Network effects
- 2. The market power of the parties
- 3. The transactions stages
 - - Wholesale and retail
 - - Terminal products and intermediate products

(2) Exemption

- 1. Efficiency
- 2. Consumers sharing
- 3. Not to seriously limit competition



VII. Tied-in sale

- Illegal rules used to be applicable conditions in America for long
- (1) Tying products and tied products are independent from each other
- (2) The Seller implemented enforcement
- (3) The seller has a dominant position in the tied product market
- (4) Having anti-competitive effects in the tied product market
- -- From a functional point of view, can be divided into two groups
- Confirmation of a monopoly agreement: Due to the direct effect on brand competition, whether it constitutes a "monopoly" mainly depends on the market force
- Efficiency: case analysis

