

## The Dragon Mirrors the Eagle: Why China Should Look to U.S. Antitrust Law in Determining How to Treat Vertical Price-Fixing

John Z. Ren

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### Recommended Citation

Ren, John Z. (2014) "The Dragon Mirrors the Eagle: Why China Should Look to U.S. Antitrust Law in Determining How to Treat Vertical Price-Fixing," *Cornell International Law Journal*: Vol. 47: Iss. 2, Article 6.  
Available at: <http://scholarship.law.cornell.edu/cilj/vol47/iss2/6>

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# The Dragon Mirrors the Eagle: Why China Should Look to U.S. Antitrust Law in Determining How to Treat Vertical Price-Fixing

John Z. Ren<sup>†</sup>

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<sup>†</sup> I would first like to thank my parents; I would have never made it anywhere close to this far without their unconditional support. I also would like to thank Professor Hay for being such a great teacher and sparking my interest in the field of Antitrust. A big thank you to the entire ILJ staff from the classes of 2014 and 2015 as well for all of their hard work in making this publication happen. Thank you to all of my CLS friends, especially my housemates, for keeping me sane throughout the whole process. Enjoy!

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## Introduction

On August 30, 2007, China took a momentous step by adopting its anti-monopoly law (AML).<sup>1</sup> The main goals of the AML are to prevent monopolistic conduct, protect fair competition, enhance economic efficiency, protect consumer and public interest, and promote healthy growth in China's socialist market economy.<sup>2</sup> Adopted decades after China began its transformation from a centrally-planned economy into a free-market economy, the AML represents an attempt to create a coherent and comprehensive approach to promoting the competition that is essential to a properly functioning market economy.<sup>3</sup> The adoption of the AML was very contentious due to the competing incentives of reining in the monopolistic power of State Owned Enterprises (SOEs) and retaining absolute control in certain critical sectors of the economy.<sup>4</sup>

On August 1, 2013, the Shanghai High Court ruled in *Johnson & Johnson v. Rainbow* that the manufacturer Johnson & Johnson had violated the

1. See Bruce M. Owen et al., *China's Competition Policy Reforms: The Anti-Monopoly Law and Beyond*, 75 ANTITRUST L. J. 231, 232 (2008).

2. Jiangxiao Athena Hou & Jane Yi, *A Progress Report on the Implementation of China's Anti-Monopoly Law*, 20 COMPETITION: J. ANTITRUST & UNFAIR COMPETITION LAW SECTION STATE BAR CAL. 79 (2011).

3. See Owen, *supra* note 1.

4. See *id.* at 244. These competing objectives create a unique tension that other countries, like the United States, do not have to face.

AML by agreeing on a resale price maintenance (RPM) system with several distributors.<sup>5</sup> *Johnson & Johnson* was a case of first impression regarding the treatment of vertical price-fixing agreements, specifically RPMs, under the AML.<sup>6</sup> Vertical price-fixing agreements arise when a manufacturer decides to limit the degree and nature of competition among its dealers.<sup>7</sup> RPMs occur when a manufacturer fixes a minimum or maximum price at which the dealers can resell the product.<sup>8</sup>

Decided on the sixth anniversary of the AML's adoption,<sup>9</sup> *Johnson & Johnson* may hint at how China will apply the AML to vertical price-fixing in cases. However, uncertainty remains in this area because court decisions are not binding in China.<sup>10</sup> Furthermore, while the Chinese AML makes it clear that horizontal price-fixing agreements are *per se* illegal, it is silent as to whether the *per se* rule will govern the analysis of vertical price-fixing agreements.<sup>11</sup>

The National Development Reform Commission (NDRC), a Chinese administrative agency that is analogous to the Federal Trade Commission, has taken the strict liability or *per se* approach when dealing with RPMs.<sup>12</sup> However, the Shanghai High Court applied a more factor-based "rule of reason" approach in *Johnson & Johnson*.<sup>13</sup> Whether China will implement the *per se* or the rule of reason approach when dealing with RPMs is critical, as it will have a huge impact on manufacturer-dealer relationships as well as consumer welfare in China's rapidly expanding economy.

The contentious history regarding the treatment of vertical price-fixing and RPMs in the United States may serve as valuable guidance for Chinese lawmakers and judges.<sup>14</sup> Long ruled to be *per se* illegal under Section 1 of the Sherman Antitrust Act,<sup>15</sup> RPMs are now analyzed under the rule of reason analysis in the United States.<sup>16</sup> The Supreme Court's 2007 decision to reverse almost 100 years of precedent and apply the rule of reason to

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5. See Susan Ning et al., *China: Chinese court rendered final judgment on Rainbow v. Johnson & Johnson - the first antitrust private action of vertical monopolistic agreement*, MONDAQ (Aug. 8, 2013), <http://www.mondaq.com/x/256400/Cartels+Monopolies/Chinese+court+rendered+final+judgment+on+Rainbow+v+Johnson+Johnson+the+first+antitrust+private+action+of+vertical+monopolistic+agreement>.

6. See *id.*

7. See ROBERT PITOFSKY ET AL., *TRADE REGULATION 606* (Robert C. Clark et al. eds., 6th ed. 2010).

8. See *id.*

9. See Ning, *supra* note 5.

10. See *Shanghai Court Applies "Rule of Reason" in Vertical Price Maintenance Case*, (Sept. 9, 2013), available at <http://www.dentons.com/en/insights/alerts/2013/september/9/shanghai-court-applies-rule-of-reason> [hereinafter *Shanghai Court*].

11. See *id.*

12. See *id.*

13. See *id.*

14. See Owen, *supra* note 1, at 237 (stating that countries transitioning from centrally planned economies to market economies often look to western countries for guidance in designing their competition policies).

15. See *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 408 (1911), overruled by *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

16. See *Leegin*, 551 U.S. at 881.

RPMs in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.* continues to be very controversial.<sup>17</sup> While there are compelling arguments for both sides, I will argue that China should follow American antitrust law—specifically the standard set by *Leegin*—and implement the rule of reason analysis for RPM agreements.

In making my argument, I will analyze the respective justifications behind the *per se* and rule of reason methods of analysis for vertical price-fixing. The evolution of American courts' attitudes toward vertical price-fixing has produced valuable guidelines for how this kind of behavior should be treated in China. Other important factors include the challenges that China still faces today, over thirty years after it began the transition from a centrally-planned economy to a market economy, in determining what kinds of rules fit best within its framework of a free-market economy with a dose of heavy government influence. In an attempt to answer this question, I will break down the unique economic, regulatory, and legal contexts within which the AML exists. Then, I will show why the rule of reason is the best standard to apply to vertical price-fixing in China's unique market.

## Background

China adopted the AML on August 30, 2007 to regulate competition in its relatively young free-market economy.<sup>18</sup> On August 1, 2013, the Shanghai High Court issued its first ruling on the legality of vertical price-fixing under the AML in *Johnson & Johnson*.<sup>19</sup> *Johnson & Johnson* specifically dealt with resale RPMs, a form of vertical price-fixing where the manufacturer and a distributor agree on a maximum or minimum price that consumers will pay to buy the product from the distributor.<sup>20</sup> In overruling the decision of a lower court, the Shanghai High Court applied a rule of reason approach and concluded that *Johnson & Johnson*'s resale price maintenance practices violated China's AML.<sup>21</sup>

Because court decisions are not binding in China, the *Johnson & Johnson* case is only the first step in determining how RPMs will ultimately be viewed under China's AML.<sup>22</sup> China's National Development Reform Commission has taken a *per se* approach to analyzing RPMs.<sup>23</sup> The *per se* and rule of reason approaches have been so divergent in the United States that the choice of one approach over the other will usually determine the out-

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17. See Christopher S. Kelly, *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.: The Final Blow to the Use of Per Se Rules in Judging Vertical Restraints—Why the Court Got it Wrong*, 28 N. ILL. U. L. REV. 593 (2008).

18. See Owen, *supra* note 1.

19. See Ning, *supra* note 5.

20. See *id.*; see also Jordan A. Dresnick & Thomas A. Tucker Ronzetti, *Vertical Price Agreements in the Wake of Leegin v. PSKS: Where Do We Stand Now?*, 64 U. MIAMI L. REV. 229 (2009).

21. See *Shanghai Court*, *supra* note 10.

22. See *id.*

23. See *id.*

come of an antitrust case.<sup>24</sup> Thus, the difference between the respective methods of analysis for the courts and the agencies presents a critical question of whether vertical price-fixing, specifically RPMs, should be analyzed under the *per se* or rule of reason approach.

## I. *Per Se* v. Rule of Reason in American Antitrust Law: A General Overview

The issue of whether the court should apply *per se* analysis or rule of reason analysis is paramount in any case involving the Sherman Antitrust Act because it determines what kinds of defenses are available to the defendant. There is a very fine line separating these two methods of analyses, so courts sometimes have difficulty deciding which one to use. However, courts have set out some key principles that will provide valuable guidelines to this question in the century after the enactment of the Sherman Antitrust Act.

### A. *Per Se* Rule

Courts apply the *per se* rule when the practices in question are obviously detrimental to competition and lack any redeeming value.<sup>25</sup> When applying the *per se* rule, the court will not consider defenses based on pro-competitive or necessity justifications.<sup>26</sup> Thus, one need not show actual anti-competitive effects for a finding of the agreement's illegality.<sup>27</sup> One of the earliest benchmarks with regard to the application of the *per se* rule was that all "naked restraints," or agreements solely designed for the purpose of restraining trade or competition, were illegal *per se*.<sup>28</sup> In *United States v. Addyston Pipe & Steel Co.*, the defendant piping contractors met in advance to determine the price of the winning bid for piping contracts.<sup>29</sup> The Eighth Circuit ruled that the agreement between piping companies to designate one member to win bids for public contracts fell under the scope of Section 1 of the Sherman Antitrust Act and was thus illegal.<sup>30</sup> In reaching this decision, the Court distinguished "naked restraints," which are illegal *per se* because they have no pro-competitive purpose, from "ancillary restraints," which help implement the pro-competitive effects of an under-

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24. See Edward D. Cavanagh, *The Rule of Reason Re-Examined*, 67 BUS. LAWYER 435, 436 (2012).

25. Thomas A. Piraino, Jr., *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. CAL. L. REV. 685, 691 (1991).

26. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940) ("For over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful *per se* under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense.").

27. See *id.*

28. See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 278-79 (6th Cir. 1898).

29. See *id.* at 272.

30. See *id.* at 291.

lying cooperative agreement.<sup>31</sup> The defendant's agreement constituted a naked restraint because it served no other purpose than to restrain competition between piping contractors.<sup>32</sup>

## B. Rule of Reason

The rule of reason, on the other hand, is more flexible and requires a deeper economic analysis of the agreement.<sup>33</sup> This analysis is more of a general inquiry into whether, under all circumstances, the challenged practices impose an unreasonable restraint on competition.<sup>34</sup> When applying the rule of reason analysis, the court takes into account the market power of the defendants, the purpose of the agreement, and the actual effects of the agreement.<sup>35</sup> Thus, even if an agreement seems like it restrains competition, the defendants can justify the agreement by showing that, under the totality of the circumstances, the pro-competitive justifications for the agreement outweigh the agreement's actual anti-competitive harm.<sup>36</sup>

In *Bd. of Trade of Chicago v. United States*, the defendants agreed to fix the price of grain from a certain time in the afternoon until the beginning of the next business day.<sup>37</sup> The Supreme Court applied the rule of reason and said that "[t]he true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition."<sup>38</sup> The Court found the defendant's conduct to be legal under the rule of reason analysis after analyzing the purpose, scope, and effect factors.<sup>39</sup> The purpose of the restraint was to restrict the period of the price making, and not the price making itself.<sup>40</sup> The scope of the restraint dealt with the portion of the market that was actually affected.<sup>41</sup>

## C. Benefits of Each

The main benefits of the *per se* rule are clarity and predictability for both the courts and for potential defendants.<sup>42</sup> Applying the *per se* analysis draws clear bright-line rules as to whether specific conduct is illegal or not.<sup>43</sup> These clear distinctions allow for quick decisions with low administrative costs.<sup>44</sup> Because the court is not concerned with analyzing the economic effects of the agreement, it can quickly dispose of the central

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31. See Piraino, Jr., *supra* note 25, at 688.

32. See *Addyston*, 85 F. at 291.

33. See HOLMES & MANGIARACINA, ANTITRUST LAW HANDBOOK § 2:10.

34. See *id.*

35. See *id.*

36. See *id.*

37. *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 237 (1918).

38. See *id.* at 244.

39. See *id.* at 245.

40. See *id.* at 239.

41. See *id.*

42. See Cavanagh, *supra* note 24, at 445.

43. See *id.* It is especially important for a clear rule in the price-fixing realm, where an antitrust violation can lead to criminal sanctions and treble damages.

44. See *id.*

question. With the *per se* rule, jury trials will be few and far between, and the trials that do come about will be quick. Furthermore, the *per se* rule will have a greater deterrent effect because there is a very low chance that an agreement in restraint of competition will slip through the cracks and be ruled legal. However, this increased deterrence could be detrimental, as it might stop companies from employing lawful business tactics for fear of liability.<sup>45</sup>

Rule of reason analysis removes this risk of over-deterrence by allowing courts to take a deeper look into the purpose and effect of the agreement. Using the rule of reason will usually lead to a more thorough and complete analysis of the economic effects of the alleged conduct. The consequences of applying the rule of reason are decreased efficiency and increased responsibility for judges to analyze the economic nuances of agreements.<sup>46</sup> There are concerns that forcing judges to use nuanced economic principles to analyze antitrust cases would be akin to forcing them to “set sail on a sea of doubt . . . .”<sup>47</sup>

## II. Vertical Price-Fixing: Harms and Justifications

Vertical price-fixing involves an agreement between parties at different levels of a product distribution chain to maintain the price of certain goods or services as they move through the chain.<sup>48</sup> These agreements are usually referred to as Resale Price Maintenance (RPMs).<sup>49</sup> Modern economic analysis shows that there are both anti-competitive effects, and pro-competitive justifications for RPMs.<sup>50</sup>

### A. Anti-competitive Effects

The main concern with vertical price-fixing and RPMs is that such agreements may act to facilitate cartels at the distributor level.<sup>51</sup> The manufacturer’s minimum resale price will have the same effect as an agreement between distributors to fix prices at that level.<sup>52</sup> However, because the price was actually fixed by the unilateral action of a manufacturer, the distributors who benefit from the uniformly fixed price may avoid liability under Section 1 of the Sherman Antitrust Act because there is technically no contract, combination, or conspiracy between the distributors in

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45. See *Leegin*, 551 U.S. at 895. (The possibility of over-deterrence is a logical inference that can be made from the nature of the *per se* rule as described).

46. See Cavanagh, *supra* note 24, at 445 (stating that the *per se* rule is superior to the rule of reason in promoting efficiency and ease of administration).

47. *Addyston*, 85 F. at 284.

48. See Christopher J. Pettit, *In Sharp Contrast to the Past: The Demise of the Per Se Rule Against Vertical Price Fixing*, 22 ST. MARY’S L.J. 1075, 1075 (1991).

49. See William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 984 (1985).

50. See PITOFSKY ET AL., *supra* note 7, at 607-08.

51. See *id.* at 607.

52. See *id.*



restraint of trade.<sup>53</sup>

Another concern is that RPMs will act to stabilize retailer prices at the manufacturer-set level.<sup>54</sup> RPMs will take away the ability of distributors to offer price concessions to increase sales volume.<sup>55</sup> The absence of distributor price-cutting will stabilize the manufacturer's price level because it removes an important pressure on manufacturers to cut prices in order to gain a larger market share.<sup>56</sup> Because RPMs arguably diminish manufacturer incentives to cut price in order to compete, they can have similar effects to a horizontal agreement between retailers to fix prices at a certain level.<sup>57</sup>

## B. Pro-competitive Effects

Proponents of using the rule of reason to analyze RPMs point out that RPMs can have pro-competitive justifications that do not exist under horizontal price-fixing schemes.<sup>58</sup> Thus, the idea that RPMs should be analyzed under the *per se* rule by analogy is faulty because the courts have "expressed reluctance to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.'"<sup>59</sup> One pro-competitive factor for RPMs is the promotion of inter-brand competition.<sup>60</sup> A uniform price for a manufacturer's product across a series of distributors would force companies to compete on factors other than price.<sup>61</sup> Because manufacturers are concerned about losing business with distributors to other brands who undercut their resale price, distributors can depend on manufacturers to set a reasonable and efficient resale price minimum.

Another pro-competitive factor to be taken into account is the inducement of distributors to include desired services that would boost sales. Some examples of desired services are dealer demonstrations and post-sale warranty programs.<sup>62</sup> Some of these services are highly valued by customers and would help increase the manufacturer's sales volume.<sup>63</sup> Dealers, however, often do not provide these services for fear of the "free rider" problem. When a distributor offers a desired service, such as a dealer dem-

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53. See 15 U.S.C. § 1 (2012). Section 1 only covers contracts, combinations, or conspiracies in restraint of trade. *Id.* A unilateral decision does not constitute an unlawful restraint of trade under section 1. See *United States v. Colgate & Co.*, 250 U.S. 300, 304-05 (1919).

54. See David F. Shores, *Vertical Price-Fixing and the Contract Conundrum: Beyond Monsanto*, 54 *FORDHAM L. REV.* 377, 386 (1985).

55. See Pitofsky et al., *supra* note 7, at 607.

56. See *id.*

57. See Shores, *supra* note 54, at 386.

58. See Pitofsky et al., *supra* note 7, at 607.

59. See *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997).

60. See Pitofsky et al., *supra* note 7, at 607.

61. See *id.*

62. See Gregory T. Gundlach et al., *Free Riding and Resale Price Maintenance: Insights from Marketing Research and Practice*, 55 *ANTITRUST BULL.* 381, 386 (2010), available at <http://www.unf.edu/~ggundlac/pdfs/FreeRidingPriceMaintenance.pdf>.

63. See *id.*

onstration, it has to raise the price of the product because of the associated costs.<sup>64</sup> Distributors who do not provide these desired services are often able to undercut the distributors who do offer these services.<sup>65</sup> The free rider problem arises when consumers take advantage of these dealer demonstrations to obtain valuable information, but then buy the products from the distributor who has the lower prices.<sup>66</sup> RPMs can offset the free rider problem by setting a price floor that discount distributors cannot undercut. By offsetting the free rider problem, RPMs can provide more incentives for distributors to provide these desired services, which would then boost manufacturer sale volumes.<sup>67</sup>

### III. The History of Resale Price Maintenance in the United States: From *Per Se* to Rule of Reason

#### A. Dr. Miles: Retail Price Maintenance Schemes *Per Se* Illegal

For almost a century, courts followed *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, which held that RPMs were *per se* illegal.<sup>68</sup> Plaintiff Dr. Miles Medical Company (Dr. Miles) used a secret formula to manufacture proprietary medicines and sold the products through dealers at the wholesale level.<sup>69</sup> Each sale Dr. Miles made included two restrictive agreements, which had the effect of fixing minimum resale prices at the retail and wholesale levels.<sup>70</sup> The defendant, John D. Park & Sons Company (Parks), a wholesaler of medicines, refused to enter into the required contracts imposed by Dr. Miles.<sup>71</sup> Instead, Parks obtained Dr. Miles's medicine by purchasing it from other stores that sold the medicine at a cut price in violation of Dr. Miles's agreement.<sup>72</sup>

The issue was whether Dr. Miles had the right to restrict the prices at which its dealers could sell its medicine by virtue of being the manufacturer of the medicine.<sup>73</sup> Justice Hughes ruled that Dr. Miles's restrictions were illegal, stating that "agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the

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64. *See id.*

65. *See id.* at 385.

66. *See id.* at 386.

67. *See id.* at 389.

68. *See Pitofsky et al., supra note 7, at 610.*

69. *See Dr. Miles, 220 U.S. at 374, overruled by Leegin, 551 U.S. at 877.*

70. *See id.*

71. *See id.* at 394.

72. *See id.*

73. *See id.* at 383; PITOFSKY ET AL., *supra note 7, at 611.* Dr. Miles first tried to argue that the court should analogize its secret formula to patent rights. *Dr. Miles, 220 U.S. at 401.* The Court rejected that argument, saying that there is a public interest in maintaining the free trade of a final product even if there is a monopoly in production. Dr. Miles then contended that it was entitled to add conditions to the resale of its medicines by virtue of its right to dispose of its property as pleased. The Court rejected this argument as well, reasoning that the restraint on alienation is ordinarily invalid.

enhanced price to the consumer.”<sup>74</sup> In doing so, he likened this vertical restraint to a horizontal restraint, and said such a vertical restraint would have the same effect as a situation in which Dr. Miles and a wholesaler enter into a combination to establish a minimum resale price.<sup>75</sup> The Court rejected Dr. Miles’s argument that the restraints were important to protect against the damage and confusion that would be caused by lower prices, and the Court characterized the damages suffered as “an inability to allow its favored dealers to realize increased profits brought about by the price restraints.”<sup>76</sup>

Even though the Supreme Court never stated in *Dr. Miles* that vertical price-fixing agreements are *per se* unlawful under Section 1 of the Sherman Antitrust Act, subsequent courts viewed that conclusion as a logical inference.<sup>77</sup> Thus, for almost a hundred years after the decision, courts have read *Dr. Miles* to establish the rule that vertical price-fixing, specifically RPMs, was *per se* illegal under Section 1 of the Sherman Antitrust Act.<sup>78</sup>

#### B. Colgate: Setting a Limit on the *Per Se* Rule with the Bi-Lateral/Unilateral Distinction

Because Section 1 of the Sherman Antitrust Act only prohibited concerted action, there remained the question of whether an RPM constitutes a “contract, combination, or conspiracy” under Section 1, or if it was simply a unilateral refusal to deal.<sup>79</sup> One party’s unilateral refusal to deal with another party is not a violation under Section 1.<sup>80</sup> The Supreme Court tackled this issue in *United States v. Colgate & Co.*<sup>81</sup>

Defendant Colgate manufactured soap and toiletry items and distributed them through sales to wholesale and retail distributors.<sup>82</sup> The government alleged that Colgate “knowingly and unlawfully created and engaged in a combination with . . . wholesale and retail dealers . . . for the purpose and with the effect of procuring adherence on the part of such dealers to resale prices fixed by the defendant . . . .”<sup>83</sup> The government, however, never alleged that Colgate had entered into contracts or combinations with retailers to fix prices.<sup>84</sup> Nonetheless, the government maintained that the

74. See *Dr. Miles*, 220 U.S. at 408.

75. See *id.*

76. See PITOFSKY ET AL., *supra* note 7, at 612.

77. See *id.* at 648.

78. See *id.* at 612. Federal enforcement of the *per se* rule against vertical price-fixing schemes was almost non-existent until the 1980s because of academic criticism of the rule. May need citation.

79. See 15 U.S.C. § 1 (1890).

80. See Kathryn A. Kusske, *Refusal to Deal as a Per Se Violation of the Sherman Act: Russell Stover Attacks the Colgate Doctrine*, 33 AM. U. L. REV. 463, 463 (1984). Note that a refusal to deal may be a violation of Section 2 of the Sherman Antitrust Act when it relates to monopolization or attempted monopolization. See 15 U.S.C. § 2 (1890).

81. See *United States v. Colgate & Co.*, 250 U.S. 300, 304–05 (1919).

82. See *id.* at 302.

83. See *id.*

84. See *id.* at 304–05. Rather, the allegations stated that Colgate refused to sell to retailers who would not adhere to the process. See Dresnick, *supra* note 20, at 232. .

allegations adequately charged the defendant for entering into an unlawful combination within the *Dr. Miles* doctrine.<sup>85</sup>

The issue was whether Colgate's practices constituted a violation of Section 1 of the Sherman Antitrust Act.<sup>86</sup> The Court rejected the government's contentions and held that Colgate's practices only constituted a unilateral refusal to deal with retailers who did not adhere to their minimum resale prices.<sup>87</sup> The Court noted that, in the absence of a purpose to create or maintain a monopoly, the Sherman Act does not restrict a manufacturer's right to freely exercise independent discretion about retailers to which the manufacturer will sell goods and make contracts.<sup>88</sup>

Thus, the court effectively carved out an exception to the *Dr. Miles* doctrine<sup>89</sup> by distinguishing unlawful bi-lateral price-fixing, present in *Dr. Miles*, from the lawful unilateral refusal to deal, found in *Colgate*.<sup>90</sup> Without proof of an agreement between two parties, a party's unilateral refusal to deal does not violate Section 1 of the Sherman Act, as Section 1 only reaches "contracts, combinations, or conspiracies."<sup>91</sup>

### C. *Leegin*: Doing Away With the *Per Se* Rule

However, in 2007, the Supreme Court overturned almost one hundred years of precedent in applying the *per se* rule to vertical price restraints and held that courts should apply the rule of reason instead in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*<sup>92</sup> Defendant Leegin Creative Leather Products, Inc. (*Leegin*) designed and manufactured leather products under the brand name "Brighton."<sup>93</sup> Plaintiff PSKS, Inc. (*PSKS*) operated Kay's Kloset, a women's apparel store in Texas that formerly sold Brighton products.<sup>94</sup> In 1997, *Leegin* decided to implement the "Brighton Retail Pricing and Promotion Policy."<sup>95</sup> Under this policy, *Leegin* would refuse to sell to any retailer that discounted Brighton goods below *Leegin*'s suggested amount.<sup>96</sup> In 2002, *Leegin* discovered that Kay's Kloset had been marking

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85. See *Colgate*, 250 U.S. at 306.

86. See *id.*

87. See Dresnick, *supra* note 20, at 232.

88. See *Colgate*, 250 U.S. at 306.

89. See Kusske, *supra* note 80, at 468-69.

90. See *id.* at 489. *Dr. Miles*'s practices were characterized as bi-lateral because he entered into contracts with the wholesale and retail distributors to maintain the minimum resale price. *Colgate*, on the other hand, never entered into contracts dictating a minimum floor resale price with distributors. Rather, they were charged with refusing to deal with those who refused to maintain their minimum resale price. Thus, *Colgate*'s decision was unilateral.

91. See *id.*

92. See *Leegin*, 551 U.S. at 899.

93. See *id.* at 882.

94. See *id.* Once Kay's Kloset started selling Brighton products, they would promote Brighton products by running Brighton advertisements and holding "Brighton days" in the store. Consequently, Kay's Kloset became the go to destination for Brighton products in the area.

95. See *id.* at 883.

96. See *id.* *Leegin* explained its reasoning for implementing this policy by saying: "In this age of mega stores like Macy's, Bloomingdales, May Co. and others, consumers are

down Brighton products below the suggested retail prices.<sup>97</sup> After Kay's Kloset refused Leegin's request to stop the discounts, Leegin stopped selling its products to Kay's Kloset.<sup>98</sup>

PSKS sued Leegin, alleging that Leegin had violated antitrust laws by "enter[ing] into agreements with retailers to charge only those prices fixed by Leegin."<sup>99</sup> At trial, Leegin defended on the basis that its practices merely constituted a unilateral refusal to deal and was thus lawful under Section 1 of the Sherman Act.<sup>100</sup> Leegin also tried to introduce expert testimony describing the pro-competitive effects of its arrangement, but the court applied the *per se* rule established in *Dr. Miles* and excluded the testimony because *per se* analysis does not take pro-competitive justifications into account.<sup>101</sup> The jury found for PSKS and awarded PSKS \$1.2 million in damages.<sup>102</sup>

On appeal to the Fifth Circuit, Leegin adopted a new argument. Leegin no longer disputed that it had entered into a vertical price-fixing scheme with its retailers.<sup>103</sup> Rather, it argued that such agreements should be analyzed under the rule of reason.<sup>104</sup> The Fifth Circuit rejected Leegin's argument and held *Dr. Miles* governed the instant case "[b]ecause the [Supreme] Court has consistently applied the *per se* rule to [vertical minimum price-fixing]."<sup>105</sup> Thus, the Fifth Circuit decided that the lower court did not abuse its discretion by excluding testimony from Leegin's eco-

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perplexed by promises of product quality and support of product which we believe is lacking in these large stores. Consumers are further confused by the ever popular sale, sale, sale, etc. We, at Leegin, choose to break away from the pack by selling [at] specialty stores; specialty stores that can offer the customer great quality merchandise, superb service, and support the Brighton product 365 days a year on a consistent basis. We realize that half the equation is Leegin producing great Brighton product and the other half is you, our retailer, creating great looking stores selling our products in a quality manner." *Id.* Thus, it is apparent that Leegin adopted the policy to give retailers sufficient margins to provide the customer service, which was essential to the promotion of the Brighton Brand.

97. See *id.* at 884.

98. See *id.*

99. See *id.*

100. See *id.* Unilateral refusals to deal fall under the *Colgate* exception and are not subject to the *per se* analysis that *Dr. Miles* set out for vertical price-fixing. See *Dr. Miles*, 220 U.S. at 408, *overruled by Leegin*, 551 U.S. at 877; *Colgate*, 250 U.S. at 304-05.

101. See *Leegin*, 551 U.S. at 884.

102. See *id.* The Court trebled the damages pursuant to the Sherman Act. Citation needed: will probably find needed cites for FN 102, and 104 in *Leegin*.

103. See *id.* at 885-86.

104. See *id.* at 886. Leegin made three arguments as to why the rule of reason should be applied. The court rejected all three arguments in affirming the district court's decision. First, Leegin argued that the Supreme Court has applied the *Per Se* rule inconsistently in the area of vertical price-fixing. The court rejected and said that it has applied the *Per Se* rule consistently to vertical minimum RPMs. Leegin's second argument was that its pricing policy benefitted consumers and competition. The court rejected this argument by pointing out that no such exception had been carved out under *Per Se* analysis of vertical minimum RPMs. Finally, Leegin challenged the exclusion of expert testimony regarding the pro-competitive effects. The court again rejected the argument, saying that an economic expert's testimony is irrelevant when the *Per Se* rule is applied. See Kelly, *supra* note 17, at 612.

105. See *Leegin*, 551 U.S. at 886.

conomic expert and upheld the lower court's judgment.<sup>106</sup>

Leegin appealed again, and the Supreme Court granted certiorari to decide whether vertical minimum RPM agreements should continue to be treated as *per se* unlawful according to *Dr. Miles*.<sup>107</sup> The Court overruled *Dr. Miles*, holding that vertical price restraints were to be analyzed under the rule of reason, instead of the *per se* rule, from now on.<sup>108</sup> The majority pointed out that Courts have historically confined the *per se* rule to restraints "that would always or almost always tend to restrict competition and decrease output."<sup>109</sup> Accordingly, the *per se* rule is unfit for RPMs because contemporary economic literature is "replete with procompetitive justifications of a manufacturer's use of a resale price maintenance."<sup>110</sup> The majority further reasoned that RPMs can have "either procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed."<sup>111</sup> Thus, RPMs should be analyzed under the rule of reason and not the *per se* rule because the economic impacts of a certain RPM scheme are not immediately obvious.<sup>112</sup>

#### IV. China's AML in the Context of the Chinese Economy's Transformation

##### A. Earlier Chinese Antitrust Laws

Prior to the enactment of the AML, China regulated competition through a series of statutes and administrative rules.<sup>113</sup> Some of these regulations, such as the Anti-Unfair Competition Law, were comprehensive laws that contained provisions commonly found in antitrust laws around the globe.<sup>114</sup> Other specialized laws contained additional antitrust regula-

106. *See id.*

107. *See id.* In so framing the issue, the Court took direct aim at the precedential value of *Dr. Miles*, which had sustained the *per se* illegality of vertical minimum price restraints for almost a century. *See Kelly, supra* note 17, at 613.

108. *See Leegin*, 551 U.S. at 889.

109. *Id.* at 886.

110. *See id.* The Court went on to list pro-competitive effects of vertical price restraints. One of these benefits is the elimination of free riding. The Court stated that when a retailer provides auxiliary services such as decorated showrooms and first-hand demonstrations, the manufacturer may experience the benefit through promotion of its product. However, the retailer that provides these auxiliary services often incurs higher costs and thus has to raise the price of the product. This opens the door for a discount retailer to come in and undercut the auxiliary provider's price. The free riding problem arises when consumers go to the auxiliary provider to enjoy the demonstrations and gather information, but ultimately buy the product from the discount retailer. A resale price maintenance scheme can eliminate free riding by setting a price floor so that the discounters cannot undercut and prices can auxiliary providers can effectively provide the extra services.

111. *Id.* at 894.

112. *See id.* at 887 (noting that the court has expressed reluctance to adopt *per se* rules with regard to restraints imposed in business relationship contexts, where the economic impact of certain practices is not immediately obvious).

113. *See Owen, supra* note 1, at 232.

114. *See id.* at 233. The Anti-Unfair Competition law was more of a consumer protection law than an antitrust law. The law prohibited tie-in sales, price-fixing, and bid-

tions.<sup>115</sup> For example, the Commercial Banking Law of 1995 and the Price Law of 1997 both contained provisions against improper competition and improper pricing behaviors.<sup>116</sup> Administrative rules provided more detailed interpretations of previously promulgated laws and addressed potential future issues that would likely require a quick response.<sup>117</sup> However, these rules and statutes have not been effectively implemented, largely because there is no clear enforcement mechanism.<sup>118</sup>

## B. The AML: a Comprehensive Re-Tooling of Chinese Antitrust Law with International Flavor

As a response to the fragmented state of existing antitrust law, China began the process of developing a comprehensive law to consolidate all aspects of antitrust law into a uniform set of rules in 1994.<sup>119</sup> The need for a comprehensive antitrust law can be traced back to 1978, when China began its program of economic reform aimed at introducing market-based principles to its centralized and state-run economy.<sup>120</sup> China's leadership saw the need for comprehensive anti-monopoly legislation as a necessary element of the legal system that would support this new market economy.<sup>121</sup>

While the Ministry of Commerce emerged as the principal drafting agency for the AML, many other governmental agencies also participated.<sup>122</sup> In an attempt to draft an effective policy, strong foreign influence in the drafting process came from consultations between drafting officials and the U.S. Department of Justice, the FTC, the World Bank, and the United Nations Conference on Trade and Development.<sup>123</sup> Indeed, China's AML is similar to U.S. antitrust statutes in its brevity and breadth.<sup>124</sup> Thus, interpretation and application of specific provisions of the AML are left to subsequent interpretative regulations, as well as the decisions of enforcement authorities such as courts or administrative agencies.<sup>125</sup> New court decisions with regards to vertical price-fixing are therefore very important,

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rigging. It also addressed other issues which may have been more common in China such as bribery, deceptive advertising, and coercive sales.

115. *See id.*

116. *See id.* at 234.

117. *See id.* For example, the NRDC, the Chinese analog to the FTC, issued the Provisional Rules on Prevention of Monopoly Pricing in 2003. This administrative rule addressed many unfair methods of competition.

118. *See id.*

119. *See id.* at 236.

120. Thomas R. Howell, et al., *China's New Anti-Monopoly Law: A Perspective from the United States*, 18 PAC. RIM L. & POL'Y J. 53, 55 (2009). These reforms emphasized enterprise autonomy, private ownership, and entrepreneurialism. Soon after, competition among enterprises became widespread and intense, creating a need to reign in unfair and destructive methods of competition. *See id.*

121. *See id.*

122. *See id.* at 56.

123. *See id.* Commentators believe that these extensive consultations with a wide array of organizations resulted in substantial improvements in the AML.

124. *See id.* at 59.

125. *See id.*

as the AML is silent as to how vertical-price-fixing should be treated.<sup>126</sup>

#### V. New Developments in China: *Johnson & Johnson*

On August 1, 2013, the Shanghai High Court issued the first decision regarding treatment of vertical price-fixing and resale price maintenance under the AML.<sup>127</sup> In *Johnson & Johnson*, defendant Johnson & Johnson entered into a contract with Rainbow Medical in 2008.<sup>128</sup> The contract granted Rainbow Medical the right to sell Johnson & Johnson products, but contained a provision allowing Johnson & Johnson to set a minimum price.<sup>129</sup> Two months later, Rainbow Medical submitted a bid below the minimum resale price to win a public bid to become the medical supplier for a hospital.<sup>130</sup> After Rainbow Medical refused Johnson & Johnson's requests to stop re-selling the products at such low prices, Johnson & Johnson broke relations with Rainbow Medical, eventually refusing to deal with them outright.<sup>131</sup> Rainbow Medical sued in August of 2010, claiming damages of 14 million RMB, or about \$2.3 million USD, arising from Johnson & Johnson's RPM scheme.<sup>132</sup>

The first intermediate court, or trial court, dismissed the distributor's claims against defendant Johnson & Johnson's RPM scheme because the plaintiff distributor failed to prove harm to the competition through market and product related evidence.<sup>133</sup> Johnson & Johnson proved that there were other suppliers who provided the same products; as a result, this practice did not harm competition.<sup>134</sup> Even though the first intermediate court applied the rule of reason, Johnson and Johnson's RPM system was ruled lawful.<sup>135</sup>

The Shanghai High Court reversed the decision; in doing so, the court applied similar methods of analysis as the lower court.<sup>136</sup> Rainbow still had the burden of proof to show that Johnson and Johnson's RPM created an unreasonable restraint on trade.<sup>137</sup> The Shanghai High Court considered the following factors: (1) the level of competition in the marketplace; (2) the relative negotiating power of the parties; (3) the strength of the brand; (4) the defendant's market share; (5) the motivation of the defendant in setting the price controls; and (6) any positive effect that the RPM

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126. See *Shanghai Court*, *supra* note 10.

127. See *id.*

128. See Alexander C. Kaufman, *Johnson & Johnson (JNJ) Loses Anti-Monopoly Case in China, Ordered To Pay \$85,800 To Local Dealer*, INT'L BUS. TIMES, available at <http://www.ibtimes.com/johnson-johnson-jnj-loses-anti-monopoly-case-china-ordered-pay-85800-local-dealer-1368281>.

129. See *id.*

130. See *id.*

131. See *id.*

132. See *id.*

133. See *id.*

134. See *id.*

135. See *id.*

136. See *Shanghai Court*, *supra* note 10.

137. See *id.*



arrangement may have had on competition.<sup>138</sup> The Shanghai High Court found that these factors weighed in favor of the plaintiff, and ruled that Johnson & Johnson's RPM was unlawful under the AML.<sup>139</sup>

### Analysis: Why China Should Apply the Rule of Reason for Future Cases as Well

In arguing for the application of the rule of reason in future Chinese RPM cases, I will stress the differences between vertical price restraints and horizontal price restraints. Mainly, I will argue that there are too many pro-competitive justifications for vertical price-restraints, specifically RPMs, to dispose of them quickly and without an in depth analysis under the *per se* rule. Furthermore, I will argue that the rule of reason still allows courts to strike down vertical price restraints that have more anti-competitive than pro-competitive effects. I will also argue that while the interests of efficiency and of keeping judges from engaging in economic analysis are legitimate, these arguments have lost strength over time. The interest of accurately deciding whether an RPM is pro or anti-competitive must thus override these other concerns.

In addition, a breakdown of the Chinese economy's unique features will also show that, while there are many differences between the Chinese and U.S. economies, those differences do not affect what the primary goal of antitrust law should be in both countries. In Part I, I will break down the economic context of the AML by detailing China's transformation from a pure communist system to a free market economy. In Part II, I discuss the regulatory context by framing it within the dual-mode strategy that China adopted after 1978. In Part III, I discuss the flaws of China's legal system and how they will affect the implementation of the AML going forward. In Part IV, I give an overview of the AML in the context of the Chinese economic transformation. I will also compare and contrast the differing contexts in which U.S. antitrust law and Chinese antitrust law must operate, arriving at the conclusion that both countries should focus on implementing their respective laws to create a coherent regulatory framework. In Part V, I will explain why applying the rule of reason to RPM schemes is the correct regulatory approach for China.

#### I. China's Economic Context: The Continuing Transformation

Free market competition is a relatively new phenomenon in China, as the Chinese government (State) dominated the economy prior to 1978.<sup>140</sup> China's rapid transformation from a State-dominated economy to a free market economy involved curtailing the previously unchecked State Owned Enterprises (SOEs) and the emergence of the private sector. Competition was very limited under the old system.<sup>141</sup> In fact, the only form of

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138. See *id.*

139. See *id.*

140. See Owen, *supra* note 1, at 238.

141. See *id.*

competition introduced under the old, State-dominated economy was “labor competition” among production units.<sup>142</sup>

#### A. The Turning Point of 1992: Focus on the “Socialist Market Economy”

Although economic reforms began in 1978, China did not make the establishment of the “Socialist Market Economy” a central focus of economic reforms until 1992.<sup>143</sup> In the decade that followed, broad reforms were undertaken to reconstruct many sectors of the Chinese economy, including the SOE, taxation, banking, and foreign currency systems sectors.<sup>144</sup> As a result of these reforms, private enterprise grew to fill the gap left by the reduction of SOEs.<sup>145</sup> In addition, foreign investments began to flow in, propelling these private enterprises to unprecedented rates of growth.<sup>146</sup>

#### B. The Results and Unresolved Conflicts Left In the Wake of the Revolution

Of the changes that came about after 1992, the most significant was the relative decline of the SOEs and other State-controlled enterprises and the reciprocal rise of the private sector.<sup>147</sup> In 1978, 100% of enterprises in China were State owned.<sup>148</sup> A 2003 study showed that, as of 2001, only 56.2% of capital invested went toward what can still be categorized as a “State-run” enterprise.<sup>149</sup> However, these numbers do not point toward a singular trend of disappearing SOEs. Despite the drop off in the influence of SOEs, China has stayed true to the socialist part of the Socialist Market Economy by preserving SOEs in many sectors of the economy.<sup>150</sup> As a matter of fact, 99% of private enterprises in China can be characterized as small to medium sized enterprises.<sup>151</sup> SOEs remain the largest enterprises in China, concentrated mainly in important industries, such as electricity, petroleum, railroads, aviation, telecommunications, and banking.<sup>152</sup>

The current structure of China’s economy presents an important ques-

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142. *See id.* Promoting labor competition was both an attempt to make the State-run economy more efficient and an effort to indoctrinate the general population with communist ideology. The State emphasized that workers were to give their best efforts in production because doing so would maximize benefits both for the country and for the people.

143. *See id.* at 239. Deng Xiaoping, who was Mao Ze Dong’s successor and a revered leader in his own right, initiated this policy change after conducting inspection tours of China’s southern regions.

144. *See id.*

145. *See id.*

146. *See id.*

147. *See id.*

148. *See id.*

149. *See id.*

150. *See id.* at 240.

151. *See id.* at 239.

152. *See id.*

tion regarding the role of SOEs in China's economy.<sup>153</sup> Are SOEs slowly being phased out from the bottom up? Or are they permanent powerhouses that are key features of the Socialist Market Economy? Determining the importance of SOEs in China's current economy necessitates a deeper analysis of China's regulatory and legal climates.

## II. China's Regulatory Context: Dual-Mode Regulation and the AML

### A. Why Dual-Mode Regulation?

Transforming the fundamental principles of the Chinese economy called for a transformation of the regulatory scheme as well.<sup>154</sup> China's process of reform can be best summarized as follows:

Before China's economic reforms, China's economic system was modeled after that of the former Soviet Union. For almost every major industry, a corresponding ministry existed within the government to control, manage, and coordinate production. There was no need for government 'regulation,' as the word is used in Western countries; the industries were already directly owned and managed by the State. But when China began to reduce central direction of its economy after the commencement of its economic reforms, it faced the question of what industries to regulate, and how.<sup>155</sup>

In response to the shifting market conditions, China has chosen to treat industry regulation in two ways.<sup>156</sup>

China has chosen relinquish its SOEs in "non-essential" areas such as machinery, electronics, and textiles.<sup>157</sup> The State, however, has chosen to maintain or strengthen its grip in key sectors such as electricity, petroleum, and banking.<sup>158</sup> This "Dual-Mode" regulatory framework can be traced to the coexisting policy interests of (1) promoting market competition by eliminating unnecessary government interference; and (2) maintaining influence in areas essential to national security and economic development. As a result, China's economic and regulatory policies both promote a hybrid system where government coordination and SOEs co-exist and thrive along with the market economy.

### B. The AML and the Dual-Mode Regulatory State

The debate over what kind of pro-competitive policies are appropriate for the Socialist Market Economy can be traced back to 1987, when the

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153. *See id.* The answer to this question is essential to finding the optimal implementation strategy for the AML because it clarifies the roles and objectives of other aspects of the Chinese economy with which the AML must coordinate.

154. *See id.* at 240.

155. *See id.*

156. *See id.*

157. *See id.* China has chosen to retreat from these sectors because they do not create conditions of natural monopoly and are unregulated in other market economies. Reform in these areas include dissolving government ministries that had complete control and replacing them with chambers of commerce or trade associations, which only play a regulatory role.

158. *See id.*

National People's Congress rejected an early draft of the AML.<sup>159</sup> Opponents of the AML have argued that its underlying principles are only applicable to well-developed market economies.<sup>160</sup> In other words, these opponents claim that the newness of China's private sector and the presence of its Dual-Mode regulatory scheme mean that the government should encourage the concentration of small enterprises rather than limit concentration with a comprehensive antitrust law.<sup>161</sup> As mentioned above, most of China's privately owned enterprises can be characterized as small to medium sized.<sup>162</sup> Opponents of the AML have used this point to argue that China should not focus on anti-monopoly law because smaller enterprises bring about fewer risks of abuse of power.<sup>163</sup> This theory stresses that government interference through anti-monopoly law is unwarranted because the government already has control of the enterprises that are big enough to cause problems. The remaining private enterprises are too small to have a significant impact on the operation of the market.<sup>164</sup>

However, opponents of the AML are mistaken in thinking that the absence of giant private enterprises eliminates the need for the AML. The objective of any antitrust law is to promote and maintain free market conditions in the country in which the law is to operate.<sup>165</sup> No matter how big or small Chinese private enterprises are, they must still be subject to the pressures of market competition in order to preserve consumers' ability to choose products and to promote proper functioning of the Socialist Market Economy.<sup>166</sup>

Furthermore, the changes brought about by the 1992 reforms have bolstered the case for the adoption of a coherent and comprehensive antitrust law.<sup>167</sup> The need for the AML has thus not been diminished by China's Dual-Mode regulatory scheme. Rather, implementation of the AML should be in line with China's two aims of promoting a market economy in some sectors while maintaining State control in other sectors.

### III. China's Legal Context

#### A. A Questionable Legal System

Perhaps the biggest challenge to the coherent implementation of the AML is the uncertainty presented by China's legal system. Enforcement of

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159. Wang Xiaoye, *Issues Surrounding the Drafting of China's Anti-Monopoly Law*, 3 WASH. U. GLOBAL STUD. L. REV. 285, 292 (2004).

160. *See id.*

161. *See id.*

162. *See* Owen, *supra* note 1, at 239.

163. *See* Xiaoye, *supra* note 159.

164. *See* Owen, *supra* note 1, at 240. This theory assumes that the only purpose of antitrust law is to check the power of large enterprises, such as General Motors or Ford. *See* Xiaoye, *supra* note 159, at 293.

165. *See* Xiaoye, *supra* note 159, at 293.

166. *See id.*

167. *See id.* These changes include the elimination of price controls, the diversification of enterprise ownership, and increased discretion for SOEs in managing economic affairs.

laws is often less than satisfactory because administrative agencies in China are not transparent, predictable, or reliable.<sup>168</sup> This is a significant problem because the Anti-Monopoly Enforcement Agency is responsible for enforcing the AML.<sup>169</sup> A heavier burden should be shifted onto the courts to ensure a full review of all relevant facts and legal principles, as agencies cannot be counted on to correctly implement the AML.

However, having courts play a larger role in the implementation of the AML will not resolve the Chinese legal system's issues due to the poor quality of judicial review.<sup>170</sup> Problems with judicial review of administrative actions include the narrow scope and convoluted nature of review.<sup>171</sup> Perhaps the biggest problem, however, is the court system's persistent bias in favor of administrative agencies over individuals.<sup>172</sup> This bias is of central importance because giving courts the power and discretion to reverse the decisions of administrative agencies would be a fruitless endeavor if the courts continue to improperly favor the agency by agreeing with their decisions. This bias is indicative of a larger problem known as administrative monopoly.

## B. The Administrative Monopoly

An administrative monopoly can be described as "monopolistic activities conducted by governmental bodies or their affiliated departments."<sup>173</sup> Some have argued that the administrative monopoly is the single most important issue facing China today.<sup>174</sup> The Chinese government's corrupt and non-transparent nature makes it susceptible to the evils of the administrative monopoly.<sup>175</sup> The difficulty in dealing with the administrative monopoly hinders China's ability to balance the interests of government influence and proper operation of a free-market economy by presenting the constant threat that the government will make self-interested choices.<sup>176</sup> The AML should not be expected to effectively address the administrative monopoly issue on its own.<sup>177</sup> However, the AML can offer a partial solution to the problem because

[T]he prohibitions on the abuse of power by the government in the Anti-Monopoly Law are beneficial not only for government officials to distinguish between right and wrong, and legal and illegal, but also to improve the awareness of these officials of anti-monopoly policies. From this perspective, the Anti-Monopoly Law is not only an important tool to further economic reform, but also a means to promote political reform in China.<sup>178</sup>

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168. See Owen, *supra* note 1, at 242.

169. See *id.*

170. See *id.* at 241.

171. See *id.*

172. See *id.*

173. Xiaoye, *supra* note 159, at 290.

174. See *id.*

175. See Owen, *supra* note 1, at 242.

176. See Xiaoye, *supra* note 159, at 290.

177. See *id.*

178. See *id.*

#### IV. Divergence From the U.S. Model and Real Role of SOEs

##### A. Different Economic and Regulatory Features Mean Different Objectives for Antitrust Laws

One of the most significant differences between the structures of the Chinese and U.S. economies is the presence of SOEs in China. SOEs have not had a significant presence in the U.S. since the massive privatization movements following World War II. Thus, while the U.S. regulatory framework can focus on promoting market competition, the Chinese regulatory framework must focus on balancing the need for a competitive market with a need to promote and sustain the growth of SOEs.<sup>179</sup> In fact, this delicate balancing objective is explicitly set out in the AML.<sup>180</sup> The AML states:

In SOE-controlled sectors concerning the health of national economy and national security and in sectors where state trading is authorized by law, the legal operations of the enterprises are protected by law, yet the government will supervise and regulate the prices of the goods and services provided by those enterprises to protect the interests of consumers and promote technology advancement.<sup>181</sup>

Furthermore, the AML seemingly points to self-discipline and self-regulation as two ways to keep SOEs from hurting the market economy when it states that “[t]he enterprises referenced in the foregoing clause shall conduct businesses in accordance with law, be honest, exercise strict self-discipline, and be subject to the supervision of the public. Those enterprises shall not hurt the interests of consumers by virtue of their dominant status or state trading status.”<sup>182</sup> The AML—as compared to U.S. antitrust law—demonstrates a wholly different end goal for Chinese antitrust law by setting out a framework within China’s unique economy.

At first glance, China has two seemingly contradictory objectives for SOEs. On one hand, it looks to rein in the monopolistic power of SOEs through the adoption of the AML and other reforms; on the other hand, it retains absolute control of SOEs in certain important sectors.<sup>183</sup> However, a closer look reveals that the continued presence of SOEs may benefit the Chinese economy by providing stability in certain sectors and making up for market imperfections through coordination. While the SOE system clearly does not benefit free market competition, it is also not so hostile to free market competition that it hurts the Chinese economy.<sup>184</sup>

179. See Owen, *supra* note 1, at 246.

180. See *id.*

181. See Antimonopoly Law of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 30, 2007, effective Aug. 1, 2008), *translated in and made available at* [http://www.china.org.cn/government/laws/2009-02/10/content\\_17254169.htm](http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm).

182. See *id.*

183. See Owen, *supra* note 1, at 244. The question of how to address this issue contributed to the prolonged debate over the drafting of the AML. Owen also argues that now that the AML has been enacted, balancing these two objectives will be a huge factor in determining the overall effectiveness of the AML.

184. See *id.* at 244-45.

## B. SOEs and the Free Market

Maintaining State ownership in certain sectors is not incompatible with promoting a competitive market economy in other areas.<sup>185</sup> In fact, China has even promoted competition in areas with heavy State ownership.<sup>186</sup> For example, in the telecommunications industry, China has created more competition by breaking up a large SOE into multiple entities.<sup>187</sup> Thus, the idea that SOEs cannot co-exist with the market economy is wrong.

State ownership of companies in an industry should not be equated with conferring monopoly status on a particular company or a particular group of companies. It is entirely possible to have State ownership of the companies in an industry, and yet to have the State ownership dispersed in dozens, or even hundreds, of SOEs competing against each other and against private firms. Furthermore, even if China were to decide to grant some type of exclusive status—and thus market power—to the key SOEs in the strategic sectors, such a decision need not be a license for the SOEs to *abuse* the market power thus granted.<sup>188</sup>

The result of this setup is that SOEs will constantly have a large market share and be powerful, but antitrust authorities will not allow them to abuse their power in ways that completely stifle competition.<sup>189</sup>

Even though China's economic and regulatory contexts include the distinctive feature of SOEs, the presence of these enterprises does not mean that China's economy is so different from the U.S. economy that China cannot look to the U.S. for guidance in establishing and implementing anti-trust law.

## C. Differences Are Not Determinative: U.S. Antitrust Law Is Still Helpful to China

A detailed analysis of China's economic, regulatory, and legal schemes reveal that the AML must operate in a context that differs greatly from the context in which U.S. antitrust law must operate. However, that does not mean that China cannot take cues from U.S. antitrust law in finding the best way to apply its own antitrust law.<sup>190</sup> The principles guiding U.S. antitrust law have changed along with shifting societal values when it comes to promoting competition.<sup>191</sup> Thus, the real purpose of U.S. antitrust law is to

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185. *See id.*

186. *See id.* at 245.

187. *See id.*

188. *See id.* at 244-45.

189. *See id.*

190. In fact, China has already taken cues from the United States in drafting the AML. *See* Howell et al., *supra* note 120, at 56.

191. *See* Joshua D. Wright, *The Antitrust/Consumer Protection Paradox: Two Policies at War with Each Other*, 121 *YALE L.J.* 2216, 2234 (2012). Fear of big business motivated the first half-century of decisions following the enactment of the Sherman Act. Thus, internal inconsistencies came about as a result of courts attempting to find any way to rule against big business. These internal inconsistencies declined with the rise of the "Chicago School" of antitrust economics. The Chicago School was less concerned with

promote policies that fit with the rest of the country's regulatory framework to preserve desired market conditions.<sup>192</sup> China should follow the path of the U.S. and implement the AML in a way that is coherent with the rest of its regulatory framework.

## V. China Should Follow U.S. Antitrust Law and Adopt the Rule of Reason for Vertical Price-Fixing Cases

### A. U.S. Antitrust Law Has Moved Toward the Rule of Reason for RPM Cases

The Supreme Court completed the long transition from *per se* analysis of RPM cases to using the rule of reason with *Leegin*.<sup>193</sup> Previously, *Dr. Miles* was the governing case for vertical price-fixing cases involving RPMs.<sup>194</sup> For almost a century, *Dr. Miles* held that RPM schemes were *per se* illegal.<sup>195</sup> However, *Leegin*, the original defendant who had implemented RPM, used an argument based on progressive economic research to convince the Court to finally overrule *Dr. Miles*.<sup>196</sup>

In the majority opinion, Justice Kennedy framed the issue as whether courts should abandon the *per se* rule when analyzing RPMs in the face of economic evidence that these restraints can have pro-competitive effects.<sup>197</sup> Justice Kennedy went on to explain the difference between the *per se* rule and the rule of reason in simple terms. He stated that resort to the *per se* rule is “confined to restraints . . . that would always or almost always tend to restrict competition and decrease output.”<sup>198</sup> On the other hand, the rule of reason “distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer’s best interest.”<sup>199</sup>

After a brief overview of the *Dr. Miles* case, Justice Kennedy concluded that the rationales relied upon by the holding of the case do not justify use

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the structure-conduct-performance simplification of economic analysis and ushered in a renaissance of economic research to establish a new framework for legal analysis of economic actors.

192. See Xiaoye, *supra* note 159, at 293 (stating that the purpose of any antitrust law is to promote free market competition within its own country).

193. See Dresnick, *supra* note 20, at 230–31.

194. See *id.*

195. See *Dr. Miles*, 220 U.S. at 374, *overruled by Leegin*, 551 U.S. at 877.

196. See Dresnick, *supra* note 20, at 237. *Leegin* argued that the reasoning of the *Dr. Miles* case conflicted with modern economic understanding. *Leegin* pointed out that *per se* analysis should apply only when a practice always, or almost always, results in anti-competitive effects. The defendant also focused on the pro-competitive effects of RPMs, such as promoting interbrand competition by improving retail services and thereby forcing manufacturers to compete on more than just price. See Dresnick, *supra* note 20, at 240. PSKS countered and argued that the principle of *stare decisis* should control the case, especially because the doctrine was at its strongest when dealing with interpretation of statutes like the Sherman Act. See Dresnick, *supra* note 19, at 240.

197. See Dresnick, *supra* note 20, at 243.

198. See *Leegin*, 551 U.S. at 886.

199. *Id.*



of the *per se* rule.<sup>200</sup> The Court then proceeded to examine the economic effects of vertical price-fixing.<sup>201</sup> The Court acknowledged that manufacturers have ample pro-competitive justifications for establishing RPM schemes, such as promotion of inter-brand competition and eliminating the free-rider problem.<sup>202</sup> The court also recognized that RPMs are not devoid of the potential to create unlawful and anticompetitive conduct. For example, the court stated that RPMs can function as a disguise for manufacturer or retailer cartels.<sup>203</sup> However, the fact that RPMs can create equally compelling pro-competitive effects lessened the concerns for these possible anti-competitive effects.<sup>204</sup>

The Court then addressed the issue of *stare decisis*. Justice Kennedy pointed out that the Sherman Act had always been treated as a common law statute.<sup>205</sup> Thus, the statute was intended to be a flexible standard, which could change over time with changing circumstances.<sup>206</sup> Furthermore, Justice Kennedy observed that *Dr. Miles* was decided not long after the passage of the Sherman Act, at a time when there was little knowledge of the Act's precedential powers.<sup>207</sup> Consequently, Justice Kennedy ruled that the principle of *stare decisis* did not compel a continued adherence to the application of the *per se* rule against vertical price restraints in the face of newfound economic evidence that these restraints can have pro-competitive effects.<sup>208</sup>

#### B. China Should Also Apply the Rule of Reason for RPM Cases

The rule of reason is still the appropriate approach for dealing with RPMs under the AML, even though the rule might give even more discretion and power to government officials who hold the administrative monopoly. The rule of reason is the correct principle to apply in light of China's economic and regulatory contexts because it gives the government flexibility as it pursues its two aims of freeing up certain sectors to market pressures while keeping State control over essential sectors.

While the *per se* rule could set out bright-line rules that bring more certainty and stability to the legal and administrative processes, the rule is a bad fit for the interplay between China's economic structure and regulatory scheme.<sup>209</sup> Courts applying the *per se* rule would condemn all RPM

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200. See *id.*

201. See Dresnick, *supra* note 20, at 244.

202. See *id.*

203. See *id.*

204. See *id.*

205. See *Leegin*, 551 U.S. at 889.

206. See Dresnick, *supra* note 20, at 246.

207. See *Leegin*, 551 U.S. at 900.

208. See *id.* Because the principle of *stare decisis* did not dictate implementation of the *per se* rule, the Court was free to take the new economic evidence into account and either continue to adhere to the *per se* rule or declare that the rule of reason is now appropriate for analyzing vertical price-fixing schemes.

209. See Piraino, Jr., *supra* note 25, at 691. The *per se* rule was developed as a response to the inefficiencies of antitrust litigation. It provides clear guidance to businesses and also to courts trying to decide antitrust cases.

tactics as illegal without analyzing their possible pro-competitive effects.<sup>210</sup> Consequently, Chinese courts will strike down RPM schemes that either promote inter-brand competition or eliminate the free-rider problem.<sup>211</sup> Clearly, this rigid application of the AML is not coherent with China's current regulatory scheme, which consists of differing policy aims depending on the circumstances of the enterprise.<sup>212</sup>

### C. Conclusion: Chinese Courts Got it Right in *Johnson & Johnson*

As illustrated above, the ultimate goal of any antitrust law is to promote and maintain free market conditions in its country of origin.<sup>213</sup> The task becomes more difficult when working within China's Dual-Mode regulatory framework. In addition to preserving competitive market conditions, the AML is tasked with the responsibility of checking the power of the State controlled enterprises. Chinese courts should follow the decision in *Johnson & Johnson* and apply the rule of reason in future RPM cases because the rule provides the flexibility necessary to balance China's Dual-Mode regulatory scheme.

*Johnson & Johnson* contained a classic vertical price-fixing scheme.<sup>214</sup> Johnson & Johnson included a resale price minimum in its contract with Rainbow.<sup>215</sup> After Rainbow ignored Johnson & Johnson's warnings to stop bidding below the minimum resale price for medical supply contracts, Johnson & Johnson ended their fifteen-year business relationship with Rainbow.<sup>216</sup> Rainbow thus sued Johnson & Johnson, alleging damages of the equivalent of \$2.3 million.<sup>217</sup>

The Shanghai High Court applied the Rule of Reason in analyzing Johnson & Johnson's RPM scheme.<sup>218</sup> This allowed the court to take a deeper look into the actual essence of the agreement and weigh the pro-competitive benefits that the RPM agreement could bring against any anti-competitive effects.<sup>219</sup> In doing so, the Shanghai High Court followed the U.S. model of dealing with vertical price-fixing schemes.<sup>220</sup> As previously discussed, this is the correct decision because it allows the Chinese government to be flexible in pursuing its two aims of freeing up certain sectors to market pressures while keeping State control over essential sectors. This

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210. See PITOFKY ET AL., *supra* note 7, at 607 (listing the pro-competitive effects for vertical price-fixing and RPMs).

211. *See id.*

212. *See* Xiaoye, *supra* note 159, at 293. The goal of any antitrust law is to maintain market competition in its own country. Thus, implementation of the AML must be coherent within China's unique economic, regulatory, and legal frameworks.

213. *See id.*

214. *See Kaufman, supra* note 128.

215. *See id.*

216. *See id.*

217. *See id.*

218. *See Shanghai Court, supra* note 10.

219. *See id.* Some of the factors that the court considered were the level of competition in the marketplace, the relative negotiating power of the parties, the strength of the brand, and the defendant's market share.

220. *See Leegin*, 551 U.S. at 889.

decision is not the end of the discussion for this topic because Chinese court decisions are not binding.<sup>221</sup> However, this decision by the Shanghai High Court represents a step in the right direction.

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221. See *Shanghai Court*, *supra* note 10.