

## Time to Review Pricing Practices in Your China Operations: Part II – Recent NDRC investigations

### Part II – Recent NDRC Investigations

In the second of a special three-part legal update advising clients on the significant increase in Anti-Monopoly Law (AML) enforcement activity, we focus on the National Development and Reform Commission (NDRC), the regulator responsible for enforcing the law's conduct rules to the extent they directly relate to pricing matters (e.g., price-fixing cartels or unfair high pricing by dominant firms etc.).

In [part I](#) of this update, we highlighted recent enforcement activity by the State Administration of Industry and Commerce (SAIC). In this update, we look at the NDRC's high profile investigations into the pricing of infant formula, jewellery and drugs, in what appears to be an enforcement agenda targeted at foreign companies operating in China. In light of the recent series of investigations and new record fines for resale price maintenance (RPM) practices, clients should be mindful of the focus on multinationals and be on the alert for any pricing practices that could raise issues under the AML.

### Record fines imposed on baby milk powder producers for RPM practices

Chinese news reports began to emerge in early July of a price fixing investigation of infant formula producers, most of which were foreign firms in China. On 6 August, after only five months of investigation, the NDRC imposed record fines totalling RMB669 million on six producers (ranging from 3 to 6 percent of 2012 sales revenue) for setting minimum resale prices with distributors in breach of Article 14 of the AML, despite some of them having agreed to lower their prices in light of the investigation.

According to the NDRC's statement, all of the six producers have admitted to RPM practices, and were unable to prove to the satisfaction of the NDRC that

their actions fell within the exemptions under Article 15 of the AML. The companies had imposed sanctions on the distributors that did not comply, including direct and disguised fines, deductions in rebates and refusals to supply. Biostime was singled out by the regulator for its "failure to proactively cooperate with the investigation", and accordingly received a fine amounting to 6 percent of its sales revenue in 2012 (RMB162,900,000). A pricing official at the NDRC has been quoted in the press warning of increasingly severe penalties in cases where businesses knowingly breach the law.

In addition to the payment of fines, the six companies will also be implementing corrective measures, including immediately modifying distribution agreements, sales and business policies to comply with the law, providing competition law compliance training to staff, and taking "practical action to eliminate the consequences" of past violations.

The NDRC's decision comes shortly after the Shanghai High People's Court's judgment in the *Beijing Rainbow/Johnson & Johnson* case on 1 August, which explicitly stated that RPM per se does not constitute an infringement of the AML. The regulator however did not clarify whether it applied the per se illegal or rule of reason approach, although according to its press release, the companies' actions led to inflated prices for baby milk powder, severely excluding and restricting price competition, and resulting in detriment to consumers.

Three other companies avoided penalties as they voluntarily cooperated with the NDRC under its leniency programme by providing important evidence and have voluntarily undertaken to address the regulator's concerns.

The infant formula investigation is one which has drawn significant media attention around the world, with a number of reports questioning whether the

protection of competition is the regulator's real concern. The Chinese government has been under increasing pressure to keep prices of baby milk powder under control; prices have risen by 30 percent since the melamine scandal in 2008, which drove up the demand for imported powder. Five years on, Chinese consumers have yet to regain trust in the government's ability to deal effectively with food quality control issues or confidence in local brands.

### Hong Kong retailers avoid fines in Shanghai jewellery cartel case

According to the NDRC's announcement of 13 August, five Shanghai-based retailers and the Shanghai Gold & Jewelry Trade Association have been fined a total of RMB10.59 million for fixing the price of gold and platinum products in breach of Articles 13 and 16 of the AML respectively. The retailers' fines, which were significantly lower than those imposed in the infant formula case, represented 1 percent of their 2012 revenues, while the association received the highest possible fine for a trade association (RMB500,000). Members of the trade association, including those fined by the regulator, had implemented a pricing guideline which agreed on the calculation method, formulas and permitted variations in the pricing of gold and platinum jewellery.

The fined entities have agreed to a number of corrective measures, including abolishing the pricing guidelines and promising not to facilitate or participate in any further pricing-related discussions with each other.

News of the jewellery investigation, which initially targeted 13 retailers, was first reported around the same time as the baby milk powder investigation. Hong Kong-based jewellers were reported by the Chinese media to be amongst those probed by the NDRC, although they have denied any anti-competitive practices in the pricing of their jewellery and have not been named in the NDRC's statement.

### Inquiries into drug pricing and costs

The NDRC's Evaluation Centre of Drug Pricing is currently investigating the production costs and pricing of 60 drug makers, amongst them foreign firms. The investigations are not, strictly speaking, AML related, but have been launched in light of the Price Law, Drug Administrative Law and "other relevant regulations".

According to the NDRC's announcement of 2 July, the regulator is initiating a three-month investigation of prices charged by certain foreign and domestic drug makers. The NDRC's previous monitoring of drug pricing seems to have relied on self reporting by companies, while the current investigation will involve a review and verification of financial records and documents by officials, as well as on-site inspections.

A second investigation into the costs of certain international and Chinese drug companies will look into production and distribution costs as well as pricing for 2010-12.

### Potential new investigations aimed at foreign car makers and other industries

Recent press reporting from China suggests the China Automobile Dealers Association (CADA) has been collecting data on the price of all foreign cars sold in the country for the NDRC since last year. While a CADA official has been quoted saying that the NDRC was investigating whether carmakers were setting a minimum retail price for dealers in China, the regulator has yet to specifically confirm such reports.

However, in around mid-August, the head of the Anti-Monopoly Bureau at the NDRC reportedly indicated on Chinese national television that the regulator could open investigations into the automobile as well as petroleum, banking and telecommunications industries.

### In Part III – How to handle AML investigations

In the final part of this legal update, we provide some practical and high-level recommendations on how to deal with active enforcement of the AML by the various Anti-Monopoly Enforcement Authorities in China.

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