Strong Medicine for Law Breakers – NDRC's First Antitrust Action in the Pharmaceutical Sector under the Anti-Monopoly Law

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On 14 November 2011, China's National Development and Reform Commission (NDRC) announced its decision to sanction the anti-competitive conduct of Shandong Weifang Shuntong Pharmaceutical Co. Ltd. (Shuntong) and Weifang Huaxin Medicine Trading Co. Ltd. (Huaxin). The fines imposed on the two companies are the highest for antitrust violations under the *Anti-Monopoly Law of the People's Republic of China* which took effect on 1 August 2008 (AML) so far. This case is also NDRC's first antitrust action in the pharmaceutical sector under the AML.

Background. Shuntong and Huaxin were found to have unlawfully controlled the supply of promethazine hydrochloride, the raw material of the compound reserpine used for high blood pressure treatments, and to have driven up prices. Reserpine is used by more than 10 million patients throughout China, and is on China's essential drug list.

According to NDRC's announcement, Shuntong and Huaxin gained control over the supply of promethazine hydrochloride by signing two exclusive distribution agreements with the only two domestic producers. These agreements require the two producers to seek approval from Shuntong and Huaxin prior to supplying the products to any third party. In practice, Shuntong and Huaxin therefore obtained a right to veto sales to competing distributors of promethazine hydrochloride.

Press reports (but not NDRC's announcement itself) indicated that the two promethazine hydrochloride producers agreed to grant exclusivity to Shuntong and Huaxin because the latter offered to buy the products at 40% above the market price. After gaining control over the supply of promethazine hydrochloride, Shuntong and Huaxin increased sales prices from below RMB 200 per kilogram to prices ranging from RMB 300 to RMB 1,350 per kilogram. As a result of the price increase, many manufacturers of reserpine tablets halted production due to the high price for the input raw material.

Legal reasoning. The announcement published by NDRC did not identify which AML provision was infringed. The announcement merely held that Shuntong and Huaxin had "unlawfully" gained control over the supply of promethazine hydrochloride, and stated that the AML and *Price Law of the People's Republic of China* (Price Law) prohibited such actions constituting "abuse of a monopoly position and the implementation of price monopoly conduct in order to eliminate or restrict competition, hike prices, and reap excessive profits to the detriment of consumer interests."

The lack of detail in NDRC's announcement is disappointing, as it would have been interesting for market players to know more about NDRC's legal reasoning. Indeed, on the basis of the information available from the announcement and the press reports alone, it is not easy to understand NDRC's legal analysis behind the decision. One explanation of the case would have been that NDRC objected to the concertation between Shuntong and Huaxin. A concertation between competitors (Shuntong and Huaxin both operate at the distribution level for promethazine hydrochloride) to determine a joint strategy to enter into exclusive agreements with the two producers could be deemed as cartel-like conduct – for example, market partitioning (by allocating suppliers between them).

However, the press reports also suggested that Shuntong and Huaxin are affiliated companies. Internationally, concertation or other agreements between companies of the same group do not fall under antitrust law; in many instances, the group is considered as a single economic entity on the market and antitrust law applies to it alone. Against this background, there are indications that NDRC did not rely on the concertation argument but instead held that Shuntong/Huaxin abused their dominant market position. The reference to "hiking prices" and "reaping excessive profits" would seem to support this conclusion. These two prohibitions (contained in the Price Law) apply to single companies, no prior concertation with other companies being required.

Sanctions. NDRC ordered Shuntong and Huaxin to cease the illegal conduct and to terminate their exclusive distribution agreements with the producers. It also imposed fines of close to RMB 7 million (approximately USD 1.1 million; EUR 800,000) on Shuntong and around RMB 150,000 (approximately USD 24,000; EUR 18,000) on Huaxin. The NDRC announcement stated that the sanctions were made in accordance with the AML, implying that it was this law that was applied in this case rather than the Price Law. It is not clear how NDRC arrived at this number – under the AML entering into an anti-competitive agreement or an abuse of dominant market position are both subject to a fine of between 1% and 10% of turnover of the business operator for the previous year.

Impact of decision. Despite the lack of detail on NDRC's legal reasoning, the decision is remarkable in various respects. First, it is another step in what seems to be a trend by NDRC to increase the level of fines for antitrust violations. The fine imposed on Shuntong by far exceeds the previously highest fine for an antitrust-related infringement, imposed on Unilever – around RMB 2 million (roughly USD 300,000; EUR 230,000) – a few months ago. Second and related to the previous point, the fact that the two companies fined by NDRC are domestic capital firms indicates that the nationality of the capital firms under investigation is not a decisive factor for NDRC; now the highest fine recorded for an antitrust infringement has been directed at a Chinese firm and exceeds the fines imposed in the *Unilever* decision. This second point is important as it challenges the notion that the AML has been used in a lop-sided fashion against foreign interests.

Third, and perhaps most importantly, NDRC's action against Shuntong and Huaxin is remarkable as the pharmaceutical sector is itself heavily regulated. Indeed, NDRC itself plays a major role in setting the prices of many essential drugs. To the extent that some market observers expected NDRC to stay away from a sector in which it regulates prices, this decision against Shuntong and Huaxin will be a disappointment. On the contrary, this decision seems to suggest that far from "letting go" of antitrust enforcement in the pharmaceutical sector, NDRC might view the pharmaceutical sector as being too important to be left to industry-focused regulation alone.

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