

Client Alert

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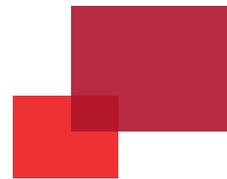
SAMR imposed record antitrust fines for abuse of dominance by pharma API distributors

In brief

On 9 April 2020, China's State Administration for Market Regulation (SAMR) fined three domestic pharmaceutical companies Shandong Kanghui Medicine Company Limited ("**Kanghui**"), Weifang Puyunhui Pharmaceutical Company Limited ("**Puyunhui**") and Weifang Taiyangshen Company Limited Pharmaceutical ("**Taiyangshen**"), a total of RMB 325.5 million (approx. USD 46.2 million) for abuse of dominance (i.e., excessive pricing and imposing unfair trading conditions) in the sale of injectable calcium gluconate active pharmaceutical ingredient (API). This is so far the largest antitrust penalty imposed in the China pharmaceutical sector. The penalty sets multiple records for Chinese antitrust enforcement in terms of setting the ceiling penalty for both antitrust violations and obstructing antitrust enforcement, and once again implies the importance of antitrust compliance in China.

Key takeaways:

- **Record-high penalties.** While the Anti-Monopoly Law (the "**AML**") provides that for abuse of dominance violations, companies can receive cumulative penalties including revenue-based fines (1% to 10% of sales for the previous year) and confiscation of illegal gains, illegal gains confiscation has been rare in the past due to the controversial calculation of "illegal gains". In the few cases where confiscation of illegal gains was imposed, the range of the revenue-based fines was usually at the lower end. In this case, Kanghui received not only the cap of monetary fines (10% of its total sales revenues in 2018), but also confiscation of illegal gains of distributing the relevant APIs concerned. The record-high penalties demonstrate the harsh consequences of violating the AML and the increasing importance of antitrust law compliance in China.
- **De facto controlling relationship.** Kanghui, Puyunhui and Taiyangshen are actually each registered as independent entities with no equity relationship. But SAMR looked at the three companies as one group in fact by finding that Kanghui fully "controls" the operation of the other two companies that were actually set up for Kanghui to transfer the relevant API distribution business in order to avoid antitrust investigations. SAMR's approach of treating the three companies as one entity group appears to be similar as the "single economic entity" concept adopted in other jurisdictions, though such concept has not been clearly indicated in the decision itself. In a way, the idea here is that where companies give the appearance of acting independently, they need to be actually doing so.
- **Benchmark for measuring excessiveness of pricing.** Excessive pricing remains to be SAMR's top priority amongst the abuse of dominance cases in China. As reflected in the decision of this case, SAMR's evolving approach to determine whether prices are "excessive" appears to be based on benchmarking of: i) examining whether the sale



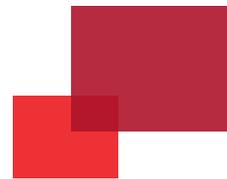
prices are significantly disproportionate to the costs; and ii) comparing price differences in the same geographic market over time. While the two benchmarking tests were previously applied disjunctively (one or the other) in some cases, SAMR appears to apply the tests on a combinatorial manner in this specific case.

- **Separate penalties for obstructing investigations.** In this case, two of the companies and 14 individuals are also imposed separate administrative penalties for obstructing the investigation. In addition, 13 of the individuals were said to be put in criminal detention because of violent resistance during which officials were injured when conducting dawn raids.¹ This is not the first in which SAMR has levied penalties on companies and individuals for obstructing investigations, but the penalty (RMB 1 million for each company, RMB 20,000 - RMB 100,000 for 14 individuals) is the harshest punishment so far meted out for such conduct. Moreover, SAMR has recently proposed to increase the fines for obstructing investigations (up to RMB 1 million for fines on individuals, up to 1% of sales revenues for fines on companies) in the draft amendments of the AML. The message sent out is that business operators in China must understand the duty to co-operate with the competition authority during antitrust investigations. Any attempts to impede an investigation would be subject to further fines or even criminal liabilities.
- **Antitrust compliance is the key.** Based on what SAMR has unveiled in the penalty decision, it is interesting to see that Kanghui did consider potential antitrust risks when conducting distribution activities. However, Kanghui chose to set up a business model by de facto controlling the other two parties to avoid antitrust exposure risks, as opposed to implementing antitrust compliance measures to fundamentally avoid the infringement risks. This case once again shows the importance of a robust antitrust compliance mechanism to protect healthy business operation in the long run.

Background

- The investigation lasted around a year and was triggered by a complaint in May 2019. SAMR found that this jointly abused their dominant position in the distribution of calcium gluconate APIs by selling at unfairly high prices and imposing unfair trade terms between August 2015 and December 2017.
- The companies argued that they were independent and did not individually command a high market share. However, SAMR found that Kanghui de facto controls the other two companies because:
 - i) Puyunhui was owned by the senior management of Kanghui and Kanghui made important commercial and strategic decisions on behalf of Puyunhui;
 - ii) from the second half of 2015 Kanghui started to gradually transfer its sales business of calcium gluconate APIs for injection to Puyunhui

¹ See Mlex report on 1 July 2019, *Companies obstructing Chinese antitrust pharma probe slammed with maximum fines, staff detained* (available at <https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1107908&siteid=202&rdir=1>)



and Taiyangshen, which began conducting business under the instructions of Kanghui; and

- iii) Kanghui's "instructions" included both oral and written documents exchanged by personnel, business arrangements such as sales orders, volume and pricing, as well as financial control over the two companies.
- SAMR found that the three companies had a combined market share of 94% of the Chinese calcium gluconate APIs sales market from August to December of 2015; 91% in the year of 2016; and 87% in 2017. SAMR also found that there was a lack of competition in the relevant markets because the API producers had *de facto* exclusively supplied the relevant products to the parties.
- SAMR found the companies' pricing of the related products were excessive because:
 - i) the parties sold the relevant product at prices ranging from 9.5 to 27.3 times than their purchase price from the API producers
 - ii) the price for the relevant product had increased by 19 to 54.6 times higher than the average market price in 2014;
 - iii) the parties had entered into multiple internal transactions to artificially increase the price of the relevant products.
- The parties were also found to have imposed unfair trade terms on downstream buyers, requiring them to sell-back the injection fluid (downstream products of calcium gluconate APIs) or sell under the directions of the parties.
- The penalties are:
 - i) Kanghui is fined for RMB 143.8 million (10% of 2018 sales), and confiscated RMB 108.9 m in illegal gains.
 - ii) Puyunhui is fined for RMB 48.3 million (9% of 2018 sales), and confiscated RMB 6.05 m in illegal gains.
 - iii) Taiyangshen is fined for RMB 12.4 million (7% of 2018 sales) and confiscated RMB 6.05 m in illegal gains.
- SAMR further imposed separate administrative penalties on Kanghui and Puyunhui for the largest possible fines for obstructing an investigation (RMB 1 million). In addition, 14 individuals working for the two companies were also handed fines ranging between RMB 20,000 and RMB 100,000.

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Case information:

http://www.samr.gov.cn/fldj/tzgg/xzcf/202004/t20200414_314227.html
http://www.samr.gov.cn/fldj/tzgg/xzcf/202004/t20200414_314229.html