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Record-high damages for antitrust claim – a new era for antitrust litigation in China?

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On 18 March 2020 the Nanjing Intermediate People's Court (court) ruled in favor of Yangtze River Pharmaceutical Group and its subsidiary (Yangtze Pharma) in an abuse of dominance case against its suppliers of active pharmaceutical ingredients (API). The court awarded the plaintiffs a record amount of damages as compensation for the anti-competitive conduct: CN¥68.8 million (close to US$10 million). This judgment is expected to encourage more companies to come forward and bring antitrust lawsuits before the Chinese courts.

Background

Yangtze Pharma is a well-known pharmaceutical manufacturer based in Jiangsu Province, near Shanghai. In May 2019 Yangtze Pharma brought an antitrust lawsuit against Hefei Yigong Pharma and its subsidiary (Yigong), as well as Yigong's contract manufacturer. The allegation was that Yigong and the contract manufacturer had abused their dominant market position in the supply of the desloratadine citrate disodium (DCD) API for manufacturing one of Yangtze Pharma's core products, DCD tablets, an antihistamine used to relieve nasal and allergy symptoms. The contract manufacturer had already settled with Yangtze Pharma, hence the judgment only concerns Yigong.

The background to the dispute is as follows: Yigong developed the API for DCD, as well as the technology to make downstream DCD drugs, i.e., DCD tablets and DCD capsules.

In 2006 Yigong assigned the manufacturing technology of DCD tablets (including an API-related patent) to Yangtze Pharma and committed to supplying DCD API (to be used as a raw material in the DCD tablet production) to Yangtze Pharma (2006 agreement). In exchange, Yangtze Pharma agreed to pay Yigong a lump-sum technology transfer fee and a fixed per-tablet royalty for the next five years.

Yigong supplied DCD API to Yangtze Pharma through the contract manufacturer from 2010 to 2017. After 2017 Yigong manufactured and supplied the DCD API through its own subsidiary. Up until Yangtze Pharma's own subsidiary obtained the approvals to manufacture DCD API by itself in November 2018, Yigong and its contract manufacturer were Yangtze Pharma's only DCD API suppliers. Over the years, in order to renew the 2006 agreements and secure the supply of DCD API, Yangtze Pharma had to accept Yigong's requests to increase prices, pay additional per-tablet royalties, and waive its liability in relation to a project to develop another drug, which did not progress as expected.

Yigong and its contract manufacturer also manufactured and sold DCD capsules, a different delivery medium for essentially the same drug as the one contained in the DCD tablets produced by Yangtze Pharma. Therefore, Yigong and Yangtze Pharma became competitors in the DCD drug market, while the API supply put them in a vertical relationship at the same time.

Judgment

At the hearing, Yangtze Pharma alleged that Yigong had abused its dominant market position in the DCD API market by (1) engaging in exclusive dealing, (2) charging excessive prices, (3) bundling and charging additional royalties, and (4) imposing unreasonable trading conditions. The court deemed all four types of conduct to be problematic under the Anti-Monopoly Law, finding Yigong to be a dominant player in the upstream DCD API market in China as the only drug license holder of DCD API until November 2018. Nonetheless, on point (3), the court dismissed the bundling theory, but found Yigong to have unreasonably charged additional royalties.

- **Exclusive dealing.** Yangtze Pharma claimed that Yigong imposed exclusivity in the new long-term API supply agreement (valid from 2017 to 2022). Along with other allegedly unfair terms, the agreement stipulated very high penalties if Yangtze Pharma wanted to work with other DCD API suppliers. As a result, when Yangtze Pharma's own subsidiary obtained the approval to manufacture DCD API in November 2018, it was still "forced" to continue procuring API from Yigong. The court found that the relevant clauses in the long-term supply agreement amounted to exclusive dealing, as Yangtze Pharma's freedom to opt out and manufacture its own DCD supply was unfairly restricted during the contract term.

- **Excessive pricing.** Yangtze Pharma argued that Yigong's prices were excessive. Over the course of eight years, Yigong raised the DCD API price from CN¥15,600/kg to CN¥48,000/kg and attempted to further increase it to CN¥60,000/kg. The court agreed that Yigong had engaged in excessive pricing. The court looked at "historical" price levels as a benchmark to evaluate the excessiveness of current prices. In particular, the court found that Yigong's historical supply price of CN¥19,900/kg was a relatively fair and reasonable price, as that price level had been in effect for five years prior to the price hikes at issue and it was clear that this historical price was above cost.

  In what looks somewhat like a reversal of the burden of proof, the court held that the defendant failed to show that its sudden, sharp price increases were justified. In particular, while the plaintiff showed that the manufacturing costs did not change much, Yigong failed to provide evidence proving that the price hikes were the result of an increase in the costs of raw materials and human capital or the company's increased investment.

  The court also examined the potential exclusionary effects of the excessive pricing practice, finding that Yigong was able to significantly increase the costs of its rival, Yangtze Pharma, in the downstream DCD market.

- **Bundling and charging additional royalties.** Along with the transfer of the rights to the DCD tablet technology, the 2006 agreement also included the assignment of a patent allegedly used in DCD API production. The plaintiffs claimed that the patent in question was not actually used in the manufacturing of DCD API and that Yigong unduly bundled the transfer of the technology with the patent assignment, thereby increasing the royalties. The court dismissed this allegation. First, it stated that the API-related patent was not required for manufacturing DCD tablets. Second, the court found that Yangtze Pharma paid no consideration for the patent

assignment in the 2006 agreement and its amendments, as the royalties were only for the technology transfer itself.

Nonetheless, the court pointed out that it was unreasonable for Yigong to continue charging royalties (of around CN¥12.2 million) for DCD tablet sales after the five-year royalty period under the 2006 agreement had expired.

- **Unreasonable conditions.** The court found that Yigong had imposed unreasonable trading conditions upon Yangtze Pharma when the companies were negotiating a new long-term supply agreement in 2017. In particular, the court took issue that, during the contract negotiations, Yigong required Yangtze Pharma to waive its liability in relation to another drug project and conditioned the conclusion of the agreement on the payment of additional per-tablet royalties (of around CN¥4.5 million). The court found that Yangtze Pharma was forced to accept these two conditions against its will in order to secure API supply, and this element of compulsion rendered the terms unreasonable. In finding whether the terms were imposed against Yangtze Pharma's will, the court examined the parties' negotiation track records (including voice records) and found that Yangtze Pharma consistently tried to object to the terms.

In terms of damages, the court awarded Yangtze Pharma total compensation of CN¥68.8 million, which included Yigong's two rounds of additional per-tablet royalties (around CN¥16.7 million), the difference between Yigong's excessive price and the court's recognized reasonable price (around CN¥51.6 million), plus legal fees. When determining the reasonable price, the court dismissed Yangtze Pharma's proposal (to use Yangtze Pharma subsidiary's manufacturing costs plus a 30 percent profit margin) as an inaccurate benchmark, but chose to rely on the historical price of CN¥19,900/kg for the reasons stated above. In addition, the court invalidated the relevant clauses in the long-term supply agreement and the agreement where Yangtze Pharma was deemed to have been forced to waive Yigong's liability.

Key takeaways

Statistically at least, plaintiffs do not have good chances of winning a private abuse of dominance lawsuit before the Chinese courts. This judgment shows that this is nonetheless possible. One of the reasons why Yangtze Pharma was successful may be that the antitrust claims were properly framed, using antitrust language, structure, and logic. This contrasts with many of the prior abuse of dominance lawsuits, which were launched by individuals against large companies such as state-owned enterprises and were often poorly drafted.

Another reason for the successful litigation outcome might be the plaintiffs' litigation strategy. Including the contract manufacturer, located in Nanjing, as co-defendant allowed the plaintiffs to file the lawsuit before the Nanjing Intermediate People's Court, even though the contract manufacturer quickly settled with the plaintiffs. That court is one of the most experienced tribunals in the antitrust space in China and is geographically closer to the domicile of the plaintiffs than that of the defendants.

In the past, the few cases where antitrust litigation has been successful resulted in low levels of damages. As a result, there has until now been a perception that the prospects of low damages awards worked as a disincentive for companies to file antitrust lawsuits in China. Hence the significance of this judgment: the amount of damages awarded by the court is the highest by any court since the Anti-Monopoly Law came into effect close to 12 years ago. The roughly US$10 million equivalent represents around two-thirds of the compensation sought by the plaintiffs. Therefore, the message that the judgment sends out is not only that abuse of dominance claims

can be litigated successfully in China, but also that it should be possible for plaintiffs to obtain reasonable amounts of damages. While this case is not necessarily a guide to future damage awards, following this judgment, we can expect plaintiffs who had previously written this avenue off as not cost-effective to be emboldened to try again, and as a result, we may see antitrust litigation becoming a more regular phenomenon in China.

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