

RPM Regulation in Japan: Reform and Modernisation

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RPM Regulation in Japan: Reform and Modernisation

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Abstract

In Japan, resale price maintenance (RPM) is, in principle, prohibited as an unfair trade practice, which means that it will be prohibited if it tends to impede fair competition without 'justifiable grounds'. The standard of illegality for RPM is proof of the likelihood of impeding fair competition in the relevant market. That means, for example, that the existence of an agreement between a manufacturer and distributors aiming to maintain resale prices is not, in itself, sufficient to make the agreement illegal under the provision of the Antimonopoly Act of Japan (AMA). Theoretically speaking, neither Japanese courts nor the Japan Fair Trade Commission (JFTC) can declare that an alleged RPM is illegal without examining the likelihood of impeding fair competition.

However, due in part to the rigid attitude of Japanese courts toward RPM and in part to the JFTC's strict regulations based on the guidelines concerning distribution and business practices, which state that RPM has serious anticompetitive effects and so are likely to impede fair and free competition, almost all RPM agreement were deemed to be per se illegal as in the US before Leegin and in the EU before the 2010 guidelines on vertical restraints.

In March 2015, the JFTC revised its distribution guidelines and clarified the 'justifiable grounds' which may lead exceptional RPM legality under the AMA. According to the revised guidelines, 'justifiable grounds' are construed as of reasonable scope and for a reasonable term where the RPM conduct would result in actual procompetitive effects, for example, through avoiding the 'free rider' problem, promote inter-brand competition and increase production thus benefiting consumers, and the procompetitive effects would not be achieved by less restrictive alternatives other than RPM.

In the face of the newly-revised distribution guidelines, this paper revisits RPM regulation under the AMA and analyses the relevant precedents by Supreme Court of Japan, pointing out the characteristics of RPM regulation in Japan.

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I Introduction – Position of RPM under AMA

Under AMA, RPM is considered as an unfair trade practice¹⁾. The AMA prohibits unfair trade practices, which is one of the three pillars of ex-post regulation scheme contained in the AMA, in addition to private monopolization (unilateral conduct)²⁾ and unreasonable restraint of trade (concerted action)³⁾. Besides these ex-post regulations, there is also a system of 'merger control' that is an ex-ante remedy in the AMA.

Historically speaking, the prohibition of unfair trade practices have been viewed as 'preventive measures' against private monopolization and unreasonable restraint of trade, differentiating them from unilateral conduct and concerted activities. Both private monopolization and unreasonable restraint of trade require market definition because they include 'a substantial restraint of competition in any particular field of trade'. On the other hand, unfair trade practices, including RPM, do not require a market definition. The prohibition only requires proof of the likelihood of an impediment to fair competition.

Article 2 (9) (iv) of AMA defines RPM as follows.

Supplying goods to another party who purchases said goods from oneself while imposing, without justifiable grounds, upon one of the restrictive conditions listed below:

(a) Causing said party to maintain the selling price of the goods that one has determined, or otherwise restricting said party's freedom of decision with regard to the selling price of the goods

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(b) Having said party cause an enterprise that purchases the goods from said party maintain the selling price of the goods that one has determined, or otherwise causing said party to restrict said enterprise's freedom of decision on the selling price of the goods.

Obviously, AMA defines the restriction of the sale price that one's trade partner can set as RPM. Subsection (b) of the Article 2 (9) (iv) extends that to the restriction imposed on a transaction between your trade partner and a third party who trades with your partner. From the wording of the first sentence of the Article, it is clear that RPM is not illegal *per se* in Japan.

II Current Regulation of RPM under 2015 Guidelines

A Vertical Restraints

AMA guidelines concerning distribution systems and business practices⁴⁾, which were issued by Japan Fair Trade Commission (JFTC) in 1991, is one of the most important guidance issued for interpreting the provisions of AMA. The new guidelines, which were revised in 2015, describe the types of conduct that may impede free and fair competition and may violate AMA in respect to Japanese distribution systems and business practices. The guidelines recognize that vertical restraints have various effects on competition depending on the situation and may have pro as well as anti-competitive effects. However, the guidelines state that vertical price restrictions, namely RPM, generally causes significant anti-competitive effects compared to vertical non-price restraints such as restrictions on products handled by distributors, restrictions of sales territories and customers of distributors. Accordingly, the guidelines declare that RPM constitutes a violation of AMA in principle.

In respect to the effects of vertical restraints on competition, the guidelines specifically recognize the following matters:

- i. Firstly, promoting competition in the distribution sector will be attained through assuring free and fair competition in each level of distribution.
- ii. Secondly, competition in the distribution sector cannot be maintained if either of intra-brand competition among distributors of the same product or the inter-brand competition between manufacturers is absent.
- iii. Finally, the guidelines propose that both negative effects and positive effects may result from vertical restraints and the effects on potential competitors at each distribution level should be taken into account when judging the legality or illegality of vertical restraints. More concretely, the guidelines explain that JFTC will decide whether vertical restraints are likely to impede fair competition or not by considering the following factors⁵⁾:

- (a) The actual conditions of inter-brand competition (market concentration, characteristics of the product, degree of product differentiation, distribution channels, difficulty of new market entry, and other relevant factors);

- (b) Actual conditions of intra-brand competition (degree of dispersion in price, business types of distributors dealing in the product, and other relevant factors) ;
- (c) Position in the market of the manufacturer that imposes the restrictions (in terms of market share, rank of brand name, and other relevant characteristics) ;
- (d) Impact of the restrictions on the business activities of the distributors (degree, terms, and conditions of the restriction, etc.) ;
- (e) Numbers of distributors affected by the restrictions, and their position in the market.

These considerations vary from the old guidelines in that the old guidelines did not acknowledge the importance of considering pro-competitive effects of vertical restraints and mentioned no concrete criteria for judging the legality or illegality of vertical restraints.

B Pro-competitive Effects of Vertical Restraints

Through recognizing pro-competitive effects in cases where vertical restraints actually promote sales of new products, facilitates new entrants to the market, or improves the quality of goods and services offered for sale, the guidelines suggest typical examples of pro-competitive effects that may result from vertical restraints⁶⁾.

First of all, avoidance of the 'free-rider' problem. It is well known that some distributors prefer not to promote the products that they are selling, but to wait for other distributors who sell the same products to run their own promotional campaigns, because they are aware of the potential boost in product demand from such campaigns but without having to contribute to such marketing efforts. In such cases, all distributors may refrain from actively implementing promotional activities, hence, fewer products in total will be sold to consumers due to the lack of information and awareness of the products concerned. To avoid this 'free-rider' problem, the guidelines propose that vertical restraints, such as territorial restrictions, here meaning allocating one sales area to one distributor, might actually be useful and pro-competitive under certain conditions.

Secondly, in the case where manufacturers hope to develop a reputation for high-quality products, it might be essential for them to sell their products through retailers who are already well known for having such a reputation for quality of products and after sales service. Limiting the choice of retailers in this way can be considered a pro-competitive vertical restraint leading to higher sales and the guidelines accept this rationale.

Thirdly, the recoupments of special investments by distributors are required to keep them investing. This occurs when a manufacturer requires its distributors to make special investments such as establishing particular facilities in order to market or provide after sales services for new products. It is well known that most distributors are unwilling to make large investments without the reassurance that they could recoup their investment in the relatively near future. In this situation, the guidelines provide that specific territorial protection for a distributor, for instance, might be a pro-competitive vertical restraint that can again promote the sales of the product concerned.

Finally, the guidelines point out that a manufacturer may try to create uniform sales

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services and standardize the quality of sales services to build its brand image in competition with other brands. In this case, limiting distributors' customers to those who could meet certain criteria or, restricting retailers' sales methods might be helpful to the manufacturer in building a good reputation with consumers.

The guidelines state that these pro-competitive effects might be considered when judging the legality or illegality of vertical restraints in addition to anti-competitive effects.

C Justification of RPM

In respect of justifying RPM, the AMA stipulates, as mentioned before, that RPM without 'justifiable grounds' is illegal and considered an unfair trade practice⁷⁾. In this regard, the new guidelines restate that RPM is not illegal if there are 'justifiable grounds'⁸⁾. According to the guidelines, 'justifiable grounds' may be found if they are reasonable in scope and for a reasonable term and would result in pro-competitive effects, through avoiding the 'free-rider' problem, promote inter-brand competition and increase demand for the product thus benefiting consumers. However, these pro-competitive effects should not be achievable as a result of less restrictive alternatives to RPM. Theoretically, the typical examples of pro-competitive effects of vertical restraints mentioned in the Part II B could be true for RPM. However, considering the guidelines' description that such pro-competitive effects should not result from any less restrictive alternatives to RPM, the situation described in the above Part II B must be interpreted restrictively for the justification of RPM.

Until 2015, the Japanese Guidelines on distribution simply stated that RPM was prohibited due to the significant anti-competitive effects among distributors. Also, the guidelines lacked any suggestion of potential pro-competitive effects arising from vertical restraints. Thus, it could be argued that the 2015 Guidelines have paved a way for the justification of RPM, while still confirming that RPM is illegal in principle.

III Precedent by the Supreme Court of Japan

A Factual Background

The legal precedents with regards to the treatment of RPM are two decisions made by the Supreme Court of Japan more than 40 years ago⁹⁾. The product at issue was infant milk powder.

The factual backgrounds of the cases are as follows. Two companies, Wakodo and Meiji Shoji, were defendants in two separate cases and were independent sole agents for different manufacturers that were producing powdered infant milk at that time. According to the evidence presented to the JFTC and upheld by the Tokyo High Court, the manufacturers' sole agents decided the prices which their respective infant powdered milk would be sold for and required both their wholesalers and retailers to sell the products at the suggested wholesale and retail prices.

Undoubtedly, this was a simple case of RPM. To maintain the retail prices, the two selling companies registered their retailers under a condition that they would promise to sell the

products at the suggested prices and the registrations would be terminated if the condition was violated. The same situation held for the wholesalers. The defendants made it clear that they would cut or reduce rebates if there was a violation. Prior to the Supreme Court's judgment, both the JFTC and the Tokyo High Court stated that both defendants had engaged in RPM conduct in violation of AMA¹⁰⁾.

B Defendants' Contention

In its appeal to the Supreme Court, Wakodo contended that the JFTC had made their decision without considering the market share of the user of RPM. At that time, the market share of Wakodo was about 10% and it was only the fourth largest producer in the market, being overwhelmed by two larger competitors whose market shares were around 41 percent and 35 percent, respectively, according to the defendant. In the end, Wakodo insisted that market share was of great importance in the case of RPM, saying that: when RPM is carried out for a product whose competitive position in the market is relatively weak, the RPM would promote inter-brand competition and would not have a tendency to impede competition throughout the entire market¹¹⁾.

On the other hand, Meiji Shoji contended that their adoption of RPM was done reasonably based on the following necessities. Firstly, to prevent their brand image from being damaged. Secondly, to secure the profits of retailers. At that time, daily commodities such as powdered milk were often used just as a decoy or bait to encourage customers to come to the shops and eventually make them purchase other products at the shops as well. Such a selling method was called 'loss leader pricing' and was prevalent at that time in Japan. Recognizing that the brand image of manufactures and profits of retailers were easily affected by loss leader pricing, the appellant claimed that they had used RPM to cope with low pricing by retailers and that they had 'justifiable reasons' to adopt RPM¹²⁾.

C Supreme Court Decision

The Supreme Court found that it was irrelevant that the JFTC had not considered the market share of a defendant who had used RPM. The rationale was that the degree of the product differentiation of powdered milk was enormous at that time and customers usually stayed with their choice of product brand even if there was a significant price difference between that brand and another brand. This simply means that the demand for one's favorite brand was price inelastic. Therefore, distributors had to stock up based on preferences of the customers. In conclusion, the Supreme Court defined a single brand market by considering the high degree of the product differentiation in this case.

Regarding the argument that RPM in low market share products may cause pro-competitive effects in relation to the competition with other brands, the Supreme Court rejected this argument saying:

Promoting inter-brand competition through RPM does not guarantee to bring the same

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economic effect as intra-brand competition, and the possibility of disturbing competition in the relevant market cannot be avoided¹³⁾.

As for the 'justifiable grounds' that exceptionally legalize RPM, the Supreme Court pointed out as follows:

'Justifiable grounds' for RPM should be considered only from the perspective of maintaining fair competition in the market. Therefore, the need of using RPM in a business environment alone would not justify the adoption of RPM¹⁴⁾.

In fact, Meiji Shoji's argument that they had used RPM to protect the brand image of their products and to secure the profits of retailers was rejected, as it was necessary for their business only, and not for the market as a whole or for the benefit of consumers.

In the end, the points of the Supreme Court decisions are summarized as follows. At first, highly differentiated product markets were taken into consideration substantially in both cases. Secondly, the Supreme Court found that there were four large companies producing powdered milk at that time and that all the four companies including defendants had implemented RPMs within individually divided brand markets because of the highly differentiated products. Therefore, the Supreme Court did not consider the market shares of the participants in the powdered milk market as a whole. It is fair to say that, in both cases, the RPMs eliminating intra-brand competitions were judged as illegal in the situation where the competition between brands was not active at all.

After the Supreme Court's decisions, apart from the specific market conditions in those cases, RPM was eventually treated as virtually illegal *per se* in Japan.

IV Characteristics of RPM Regulation in Japan

A An Unfair Trade Practice

The first point which should be noted about the characteristic of RPM regulation in Japan is that RPM is classified as an unfair trade practice under AMA. As pointed out earlier in Part I, the prohibition of unfair trade practices is one of the main pillars of regulation by the AMA, alongside with the prohibition of private monopolization and the prohibition of concerted action (cartels and bid rigging, etc.). According to the JFTC, many business practices have been recorded as a violation of unfair trade practices.

In the AMA, the category of unfair trade practices is broadly defined and include various forms of business practices which tend to impede free and fair competition. For example, concerted refusal to trade, unjust low price sales and tie-in sales, even deceptive customer inducement and abuse of dominant bargaining position are listed under the same category of unfair trade practices. Reflecting the variety of violations, illegalities of unfair trade practices are differentiated according to the nature of the violation at issue. Generally speaking, the illegal nature of unfair trade practices are considered to be: Firstly, limiting free competition

in the market. Secondly, being unfair as means of competition. Thirdly, invading or infringing the basic right of participants to compete with freely in the market. Among these three points, the illegality of RPM is considered to be the limitation of free competition in the market. This means that the illegality of RPM is practically the same as the 'substantial restraint of trade', which makes a concerted action illegal. Therefore, in theory, there could be a possibility of regulating RPM as a vertical concerted action, for example, between a manufacturer and a distributor. In fact, before the designation of unfair trade practices by the JFTC in 1953, RPM was prohibited as a vertical agreement¹⁵⁾ just as in the United States and in the European Union. However, after the creation of unfair trade practice by the JFTC, RPM has been exclusively treated as an unfair trade practice. The Supreme Court decision on powdered milk in 1975 supported JFTC's regulation policy that prohibited RPM as an unfair trade practice.

In addition, in the same year of 1953 when the JFTC created unfair trade practices, a Tokyo High Court decision declared that the application of unreasonable restraint of trade (concerted action) must be limited to horizontal agreements between business entities at a same level of trade¹⁶⁾. It is certainly fair to say that the decision had a considerable impact on the following treatment of RPM in Japan. Currently, it is theoretically possible in Japan to regulate RPM as an unreasonable restraint of trade because another subsequent judgement by Tokyo High Court relaxed its position and held that to be a concerted action participant, business entities need only to be competitors 'in essence' and that the participants can be active at different level of trade¹⁷⁾. In fact, however, RPM in Japan has not been treated as a vertical concerted action in actual cases, but still has been treated as an unfair trade practice which, in general, only require to prove the likelihood of impeding fair competition. In this regard, the treatment of RPM in Japan is different from its categorization in the United States and in the European Union.

B The existence of 'Justifiable grounds'

As mentioned earlier, RPM is prohibited in principle as it causes significant anti-competitive effects among distributors of the same brand of a product. However, according to the definition of the AMA, RPM is not illegal if it has 'justifiable grounds'. As previously mentioned in Part III, the Supreme Court of Japan stated that the 'justifiable grounds' should be considered only from the perspective of maintaining competition in the market. In past cases, neither protecting brand images against loss leader pricing nor preserving a certain industry or culture from extinction were recognized by courts as 'justifiable grounds'. In Japan, no RPM has been approved on the ground that it has any justifiable reason. This is because most RPMs in Japan have been used in the situations where a single brand had market power in the relevant market or a single brand could define a product market by itself because of its highly differentiated product.

It is clear that the 2015 Guidelines' intention is to clarify the 'justifiable grounds', which have been rarely discussed in Japan, considering recent development of RPM regulation in the world, especially in the United States and in the European Union. In the US, *Leegin*

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decision¹⁸⁾ has changed the standard for RPM from 'per se illegal' to 'rule of reason'. In the EU, 2010 Guidelines on Vertical Restraints¹⁹⁾ have opened up a possibility that RPM could be exempted on an individual assessment basis under Article 101 (3) TFEU, although RPM is still constrained by a 'hard core restriction' that would not be qualified for 'block exemption'. These international trends certainly affected the revision of the distribution guidelines in Japan. It is fair to say that the AMA's fundamental framework of regulation for RPM is similar to Article 101 TFEU in the sense that in exceptional cases it also leaves room in which RPM could be treated as a legal practice.

C Exemptions

It is a characteristic of RPM regulation in Japan that a few exemptions still exist. According to Article 23 (1) AMA, a manufacturer is allowed to maintain the resale price of consumer commodities designated by the JFTC. Until 1992, some cosmetic products and medical products were designated. However, currently, no commodity is designated, as an exemption, under the provision of the Article.

Moreover, according to Article 23 (4) AMA, a publisher is allowed to maintain the resale price of certain copyrighted products. Nevertheless, note that not all copyrighted products are exempted from the application of the AMA. At present, only six products, books, magazines, newspapers, CDs, video tapes, and analog records, are exempted from the prohibition of RPM. Unlike the exemption for consumer commodities, which is considered almost dead, the exemption for the six copyrighted products is expected to last for a while because the related industries strongly object to the abolition of this special treatment under the AMA to protect their 'vested interests'. In March 2001, the JFTC issued a statement that the exemption for copyrighted products would be maintained for the time being. There is no change for more than 15 years since the statement.

D Weak Deterrent

Finally, about the weak deterrents against RPM. Unlike unreasonable restraint of trade, which has become a target for surcharges²⁰⁾ since the unique administrative penalty was introduced in 1977, unfair trade practices including RPM were not a subject of the surcharges until recent years. Due to the amendment of the AMA in 2009, RPM has become a target for surcharges. However, surcharges would not be levied against a business entity that has used RPM for the first time in the past ten years. In other words, surcharges on RPM would only be levied for the second violation within the past ten years, according to the AMA²¹⁾. The amount of surcharge is determined by multiplying the fixed rate, which is provided in AMA, to the sales amount of the product in question during the period of violation. Surcharges are so rigid with regard to application that the JFTC has no discretionary power as to the imposition of and amount of surcharge in actual violation cases. In case of surcharges against RPM, the maximum amount is only 3 percent of the sales amount of the products in question during the implementation period²²⁾.

In addition, no criminal penalty is taken in case of RPM. Theoretically, under AMA, criminal

penalty can be taken only in case of private monopolization and unreasonable restraint of trade²³⁾, and cannot be taken at all in case of unfair trade practices. As long as RPM remains in the category of unfair trade practices, criminal penalty would definitely not become a deterrent against RPM.

In Japan, damage claims are possible based on Article 25 of the AMA or based on Article 709 of the Civil Code even in case of unfair trade practices. In 2001, injunctive relief was introduced in Article 24 AMA for unfair trade practices. However, in Japan, private actions such as damage claims and injunctive relief are still inactive in reality, especially in case of RPM.

Considering the points above, it can be said that Cease and Desist Orders²⁴⁾, which are issued by the JFTC in order to remove violation acts and to recover sound competition in the market, are still a substantial deterrent against RPM.

V Conclusion – Challenges for the future

It is true that the new distribution guidelines have paved a way for the justification of RPM, but there are some challenges for the future. First of all, the guidelines are lacking in clear description of the situations where RPM could work for the promotion of market competition and ultimately for the benefit of consumers. They mention only a couple of results that RPM may bring: actual promotion of inter-brand competition; an increase of demand for the product; and improvement of consumer benefit. These are certainly important outcomes that should be observed when justifying RPM. However, from the perspective of predictability, mentioning the presence of those outcomes alone might not be sufficient to provide business entities with clear-cut guidance for their adoption of RPM.

Secondly, there is no distinction between maximum RPM and minimum RPM in the Japanese guidelines. This might mean that, under AMA, all vertical price restraints are regarded as contrary to the essential freedom of resellers that they can decide their own sales prices. However, unlike minimum RPM, it is well known that maximum RPM can prevent distributors from pricing too high, solving what is called ‘double marginalisation problem’ under which everyone in the market is worse off. The economic theory underpinning maximum RPM presupposes that both upstream and downstream firms in a vertical supply chain have their respective market powers and apply their own mark-ups in prices over respective marginal costs. Therefore, it is also true that ‘double marginalisation problem’ does not occur in every vertical transaction. However, considering the development of the treatment of maximum RPM in the US²⁵⁾ and in the EU²⁶⁾, the JFTC’s attitude towards RPM, which does not distinguish maximum RPM from minimum RPM, seems fairly odd.

Finally, from a broader perspective beyond the amendment of the distribution guidelines, repositioning RPM as a vertical concerted action in the AMA should be aimed in the long run. This may lead to dismantling the prohibition category ‘unfair trade practices’, but would greatly contribute to clarifying the standard of illegality for RPM. Once such a drastic legislative measure comes true, RPM must definitely be assessed based on its substantial

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lessening of competition in a relevant market, instead of being considered if it is likely to impede fair competition. In that case, by the definition of 'unreasonable restraint of trade', it would be clear that RPM always requires market definition, without depending on the interpretation that RPM is an unfair trade practice whose illegality is considered to be the limitation of free competition in a relevant market. Additionally, repositioning RPM as a vertical concerted action would strengthen the enforcement of RPM due to the possibility that RPM could be subjected to both surcharges and criminal penalties in addition to administrative orders by the JFTC. Needless to say, the introduction of discretion type surcharges, which is adopted in the EU and is now being discussed in Japan, would be helpful to improve the current weak enforcement regarding RPM.

Notes

- 1) Article 2 (9) (iv) AMA.
- 2) Article 2 (5) AMA.
- 3) Article 2 (6) AMA.
- 4) Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act (hereinafter, Distribution Guidelines).
- 5) Distribution Guidelines, Part II 3 (1).
- 6) *Id.* at Part II 3 (2).
- 7) *See supra* note 1.
- 8) Distribution Guidelines, Part II 1, 2 (1).
- 9) *Wakodo*, Supreme Court judgment of 10 July 1975, *Minshū*, Vol.29, No.6, P.888, *Meiji Shoji*, Supreme Court judgment of 11 July 1975, *Minshū*, Vol.29, No.6, P.951.
- 10) For *Wakodo*, *see* JFTC decision of 11 October 1968, *Shinketsushu*, Vol.15, P.98 and Tokyo High Court judgment of 17 July 1971, *Minshū*, Vol.29, No.6, P.923.
For *Meiji Shoji*, *see* JFTC decision of 11 October 1968, *Shinketsushu*, Vol.15, P.67 and Tokyo High Court judgment of 17 July 1971, *Minshū*, Vol.29, No.6, P.938.
- 11) *See supra* note 8.
- 12) *Id.*
- 13) *See supra Minshū*, Vol.29, No.6 at P.895.
- 14) *Id.* at P.959.
- 15) JFTC decision of 18 September 1950, *Shinketsushu*, Vol.2, P.103.
- 16) Tokyo High Court judgment of 9 March 1953, *Kōminshū*, Vol.6, No.9, P.435.
- 17) Tokyo High Court judgment of 14 December 1993, *Shinketsushu*, Vol.40, P.776.
- 18) *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).
- 19) Commission Notice, Guidelines on Vertical Restraints, OJ C130/1, 19 May 2010 (hereinafter, 2010 Guidelines).
- 20) Under AMA, 'surcharge' means an administrative monetary penalty imposed by JFTC on a business entity which violated AMA.
- 21) Article 20-5 AMA.
- 22) *Id.*
- 23) Article 89 (1) (i) AMA.
- 24) For 'unfair trade practices' including RPM, *see* Article 20 AMA.
- 25) *State Oil Co. v. Kahn*, 522 U.S. 3 (1997).
- 26) 2010 Guidelines, para 107 (f) and 229.

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