

CPI's Asia Column Presents:

Abuse of Dominance: New Developments in the Tetra Pak Decision

*Susan Xuanfeng & Kate Heyue Peng,
King & Wood Mallesons (Beijing)*

December 2016



Copyright ©2016

Competition Policy International, Inc. for more information visit CompetitionPolicyInternational.com

On 16 November 2016, the State Administration for Industry and Commerce of the People's Republic of China (“SAIC”) published its administrative penalty decision to fine Tetra Pak (“TP”) for abuse of dominant market position. The SAIC imposed a fine totaling RMB 667.7 million bringing an end to a case that started in January 2012 and lasted for almost five years.

The SAIC found that from 2009 to 2013, TP abused its dominant position in aseptic carton packaging machinery for liquid food products (“**machinery market**”), technical services for aseptic carton packaging machinery for liquid food products (“**technical service market**”), and cartons for liquid food product aseptic packaging (“**carton market**”). The SAIC found that in Mainland China TP had without justifiable reasons conducted tie-in sales, exclusive dealing and loyalty discounts.

In this case the SAIC for the first time defined a “loyalty discount” as an “other forms of abuse of dominant market position confirmed as such by the Anti-Monopoly Enforcement Authority under the State Council” regulated under Article 17(1) (vii) of the Anti-Monopoly Law (the “AML”). By doing so, the theory of loyalty discounting (already widely acknowledged in the EU and the US) has been adopted as the seventh approach to regulate abusive conduct. This decision has great practical significance, and also brings new challenges and requirements to companies’ compliance mechanisms.

In this article, we will review the case and the important legal issues it raises.

I. Addressees of the Decision

The SAIC addressed the decision to six entities¹ of the TP Group, and decided that the Group had dominant market position and had abused this position. In the end, the SAIC imposed fines on the six entities as a whole.

Points to note:

There is no “single economic entity” doctrine under the AML. Nor does the AML explicitly list factors² to be considered when applying the “single economic entity” doctrine as some jurisdictions do (e.g. the EU). However, according to the current AML enforcement practice, it seems that in practice the concept of “single economic entity” has been to some extent taken into consideration by the enforcement authorities. For example, in the Chongqing Qingyang cartel case³, the National Development and Reform Commission (“NDRC”) concluded that two

¹ Namely Tetra Pak International S.A. (headquarter of TP), Tetra Pak (China) Ltd. (headquarter of TP in Greater China Region), Tetra Pak Packaging (Kunshan) Ltd., Tetra Pak Packaging (Beijing) Ltd., Tetra Pak Packaging (Foshan) Ltd., and Tetra Pak Packaging (Hohhot) Ltd.

² Such as the equity relationship between entities, composition and voting mechanism of boards of directors or supervisors, appointment and dismissal of senior management, veto rights on daily operations or strategic matters, etc.

³ Administrative Penalty Decision of the NDRC [2016] No.1.

affiliated companies (Chongqing Qingyang and Chongqing Datong) were common actors⁴. Nevertheless, it remains to be seen through future enforcement action about when the “single economic entity” doctrine will be applied and what factors will be considered when doing so.

II. Definition of the Relevant Market

The SAIC defined three relevant product markets in this case: the machinery market, technical service market, and carton market. The SAIC defined the geographic market as Mainland China. When defining the relevant markets, the SAIC followed principles provided in the Guidance of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market to conduct its analysis from both demand substitution and supply substitution⁵ perspectives. Please see the chart below for details.

Relevant Product Market Reasons	Machinery Market	Technical Service Market (Spare Part + Maintenance Service)	Carton Market
Demand-side Substitutability	<ul style="list-style-type: none"> Distinct from non-aseptic packaging machinery and aseptic packaging machinery using other materials concerning technical characteristics and content to be packaged; 	<ul style="list-style-type: none"> Due to distinct differences between different types of machinery, there is no substitutable relationship between technical services for 	<ul style="list-style-type: none"> Has distinct differences with other packaging materials in aseptic performance, content to be packaged, system costs, applicable

⁴ The NDRC found that the largest shareholder of Chongqing Qingyang and Chongqing Datong were the same, the vice General Manager in charge of preparation sales in Chongqing Qingyang was also the General Manager of Chongqing Datong, and the financial vice-manager of Chongqing Qingyang was also the financial chief of Chongqing Datong. Since 2014, allopurinol tablets of Qingyang brand was sold and billed by Chongqing Datong, and sales management of Chongqing Qingyang and Chongqing Datong was charged by the same person. Therefore, the NDRC concluded that Chongqing Qingyang and Chongqing Datong had consistency in decisions and actions and co-represented one party in the monopoly agreement that sold allopurinol tablets of brand Qingyang.

⁵ From the demand-side, the lower the substitutability between products is, the weaker the competitive relationship between the products is and the more unlikely it is for those products to be in the same relevant market. For supply-side substitutability, the more input and time needed and the more risks born for transforming production facilities to manufacture closely substitutable products, the lower the degree of substitutability is. Correspondingly it is harder for other operators to enter the relevant market rapidly and impose competition restraints on the relevant supplier. Therefore, it is unlikely for other operators to be in the same market with the relevant supplier.

	<ul style="list-style-type: none"> High switching cost for demanders. 	different types of machineries.	machineries, etc.
Supply-side Substitutability	<ul style="list-style-type: none"> A huge amount of capital investment, know-how, and mature distribution channels needed to enter into the market; Core technical barriers of high-end machineries; Due to differences in the technologies and manufacturing processes, manufacturers in other packaging machinery markets cannot switch production rapidly. 	<ul style="list-style-type: none"> There are barriers such as the complexity of machineries, the specificity of spare parts, etc. 	<ul style="list-style-type: none"> Carton market has comparatively high barriers in terms of capital investment and technology. Practical entry barriers exist due to customer preference and difficulty to procure certain raw materials.
<div>Relevant Geographic Market</div> <div>Reasons</div>	Mainland China		
Demand-side Substitutability	<ul style="list-style-type: none"> Liquid food product manufacturers in Mainland China have long-term, stable and unique demands on machinery, technical services and cartons. 		
Supply-side Substitutability	<ul style="list-style-type: none"> Supplies are evidently regional; all of the manufacturers put products into the Chinese market through the sales channels in Mainland China. 		

Points to note:

- The Antitrust Guidelines for Automotive Industry (Draft for Comments) mention that since “compatibility and lock-in effect exists in automotive aftermarket, automobile brand becomes an important relevant factor to be considered when defining the automotive aftermarket.” This is generally interpreted to mean that given the existence of a “lock-in effect”, the automotive aftermarket is likely to be defined as a single-brand market, where a manufacturer without dominant position in the automobile market is likely to hold a

dominant position in aftermarket. In the TP case, the SAIC repeatedly reaffirms that “customers have a relatively strong dependency on machinery manufacturers”, “once a specific kind of packaging machinery is selected, it will be very expensive to switch to other packaging machines”, “TP machines’ spare parts are mainly provided by TP”, and that considering “the complexity of machineries and specificity of spare parts”, “customers highly rely on TP for major repair works”. However, it seems that SAIC does not think that these facts are sufficient to define a single-brand market, which reflects SAIC’s prudent attitude towards this issue. The single-brand market theory would affect manufacturers’ compliance obligations directly. Its development in China has always been a hot topic. We anticipate further clarifications on this theory’s application through future legislation and enforcement activities.

III. Determination of the Dominant Market Position

To determine TP’s market position in the three relevant markets, the SAIC mainly considered the following:

- (1) TP’s market share and competition status in the relevant markets, including its competitive advantages in the relevant markets reflected by the changes of its sales margin and its profitability, etc.;
- (2) TP’s ability to control the market, particularly prices and discounts as well as other trading conditions;
- (3) the extent to which other business operators (especially the users) depend on TP; and
- (4) the difficulty that other business operators encounter when entering the relevant markets.

Points to note:

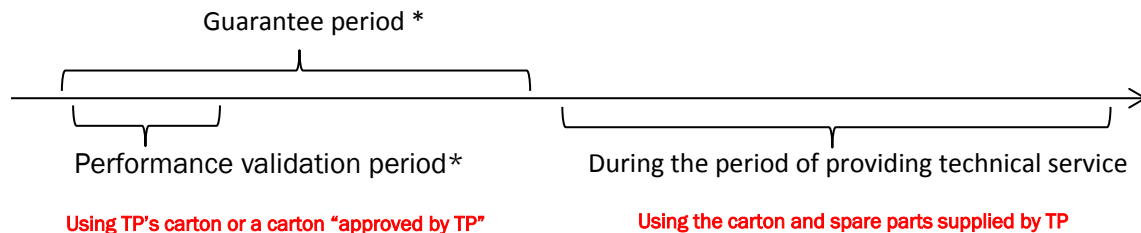
- Although the SAIC found that that TP’s market share in middle and low-end machinery market and carton market declined in recent years, it still determined that TP has dominant market position. This is mainly based on the fact that TP’s profit margin and profitability continued increasing in recent years, which reflects that competition in the relevant markets did not impair TP’s pricing ability and product competitiveness and that competitors did not create obvious competition restraints on TP. This shows again that when conducting compliance reviews, it is not sufficient to only look at market share to evaluate market power.
- When analyzing TP’s ability to control the markets, the SAIC also took three kinds of abusive behaviors into consideration. It concluded that TP’s imposition of unreasonable trading conditions and complex discounts demonstrated its ability to control the markets, which to some extent corresponds to the Supreme Court’s view in the Qihoo360 v. Tencent. In this case the court found that defendant’s market position can be evaluated through direct evidence of an elimination or restriction of competition. This approach is

especially valuable when it is hard to accurately define the relevant market. Currently, there are relatively few cases in relation to the abuse of dominant market position. Whether enforcement authorities will skip the definition of relevant market and directly estimate the company's market power through its activities and its impact on market competition, or whether they will only use this approach as a supplementary tool to evaluate the company's market power is a question to be answered in future enforcement actions.

IV. Abusive Conduct

1. Tie-in sales of cartons without justification

Using TP's carton, a carton "with equivalent quality", or a carton that satisfies "the lowest specification standard."



*The performance validation period is a period of 8-12 weeks after a customer begins commercial production (the first 8-12 weeks of the guarantee period), which is aimed to verify whether the machinery can achieve negotiated performance goals.

*Guarantee period is a period of 12 months after the machinery has been debugged and begins commercial production or a period of 18 months after the machinery has been delivered. The guarantee period is equivalent to the warranty period.

As shown in the above chart, from 2009 to 2013 TP set up performance validation periods (i.e. a period for testing the machinery's performance) and guarantee periods (i.e. the warranty period) when selling or renting its machinery. During these periods, TP required customers to use its cartons or cartons "approved by TP", "with equivalent quality" or "satisfying the lowest specification standard." Moreover, when providing technical service, TP's prerequisite for the provision of guaranty to the machinery's operation was that customers must use cartons provided by TP.

When analyzing these tie-in sales, the SAIC mainly considered three factors: (1) from the products functions, demands, and trading customs perspectives, paper-based aseptic packaging machinery and technical services both are independent from cartons; (2) the relevant behaviors were conducted without justifiable reasons; (3) the relevant conduct damaged competition in the market of the tied product (i.e. carton).

The SAIC concluded that TP was using its dominant position in machinery and technical service markets to impose restrictions on and affect customer's usage of cartons, which damaged the competition in the carton market. Therefore, TP's tie-in sales was a form of "implementing tie-in sales or imposing other unreasonable trading conditions at the time of trading without justifiable reasons" as prohibited by Article 17(1) (v) of the AML.

Points to note:

- In its decision the SAIC did not specifically emphasize the 3rd element of tie-in sales as per *Qihoo360 v. Tencent*⁶, because it did not analyze whether TP forced its customers to accept the tied products. However, in the decision the SAIC pointed out that when selling or renting its machinery, the parties all signed the standard contract provided by TP. In that regard, it seems that the SAIC also considered whether customers had voluntarily accepted the tied cartons.
- When analyzing whether relevant behaviors have "justifiable reasons", the SAIC mainly considered whether tie-in sales were in accordance with industry customs, if it was necessary for operators to conduct ordinary business operations or for public benefit, if tie-in sales exceeded the operator's right and power in the transaction, etc. This analysis provides some guidance for companies when evaluating whether their tie-in sales are justifiable.
- Short-term tie-in sales may also be regarded as an abusive behavior. The time limits would mainly affect the analysis of anti-competition effect caused by the behavior. In the TP case, the SAIC pointed out that although the performance validation period did not seem to be very long, customers would face extra costs to switch to other manufacturers' cartons after the performance validation period because customers would need to debug and test the machinery again. Therefore tie-in sales during the performance validation period still has the effect of restricting customers to TP's carton and impeding customer's usage of or attempts to use other cartons thereby damaging competition in the carton market.
- Allowing customers to use cartons "with equivalent quality" or that "satisfy the lowest specification standard" may have the effect of inducing customers to use the tied product, due to the ambiguity of standards or because the requirement of being "equivalent" or satisfying "the lowest specification standard" would increase the burden on customers to conduct evaluations or tests. When there is relevant national standard, proposing a

⁶ As to the alleged tying by Tencent, the Supreme Court sets out the following criteria for "tying" for the purposes of Article 17 of the AML: 1) the tied product/service is distinct from the tying product/service; 2) the undertaking in question has a dominant position in the tying product/service market; 3) the dominant undertaking imposes certain restrictions on the consumers so that the consumers have no choice but to accept the tying product/service with the tied product/service; 4) tying is not justifiable, in the sense that it conflicts with trade customs and trade habits or ignores the tying product's functions; and 5) the alleged tying has a negative impact on competition. The summary and the criteria illustrated by the Supreme Court can be used as guidelines for understanding and proving abusive tying and bundling practices in the future.

higher standard or conducting tie-in sales for reasons of securing safe manufacture or guarantying product quality may not be acceptable to the AML enforcement authorities.

2. Exclusive dealing without justification

The SAIC found that the raw materials for cartons include brown paper and white paper. Brown paper has advantages over white paper in terms of cost and performance. By 2014, Foshan Huaxin Packaging Ltd. and its subsidiary Zhuhai Special Economic Zone Hongta Renheng Paper Ltd. (collectively “Hongta”) were the only companies that are able to achieve production at scale of brown paper.

Since 2009, TP “jointly developed” brown paper with Hongta. In 2011, TP and Hongta signed a *Memorandum of Understanding* and agreed that “the production capacity (of Hongta) shall be employed exclusively to produce brown paper for TP and its affiliates within the term of three years as agreed in the Cooperation Agreement”. In addition, as provided in the *Supply and Cooperation Agreement* which is signed in 2012, “Hongta shall not provide any third party with products that were produced by implementing TP technical information”.

The SAIC found that Hongta solely owns the patent of producing brown paper, and the technical information that TP excludes Hongta from using is not proprietarily owned by TP. These restrictions on the use of non-proprietary technical information excluded Hongta from supplying brown paper to a third party. Therefore, restricting Hongta from cooperating with other carton manufacturers and restricting Hongta’s implementation of non-proprietary technical information eliminated and restricted competition in the carton market.

Based on this, the SAIC held that TP’s exclusive dealing behavior constituted a violation of Article 17(1) (iv) of the AML, which prohibits business operators with dominant market positions from “restricting the trading party to deal exclusively with the business operator or with the designated business operators without any justifiable reasons”.

Points to note

- When a business operator possesses non-proprietary technical information, it would be difficult to regard its behavior of restricting its trading party’s implementation of such non-proprietary technical information (which may affect the production and supply of the relevant product) as justifiable reasons. Even for the IP rights holder, if it prohibits its trading party, in the IP related transactions, from dealing with a third party or if it imposes restrictions on the trading party’s selection of trading partners, trading territory, or other trading conditions etc., such behaviors may face with the risks of being considered as abuse of IP rights to impose unreasonable conditions.

3. Loyalty discounts that eliminate or restrict competition

The SAIC identifies two types of loyalty discounts TP adopted in its carton business between 2009 and 2013: 1) retroactive accumulative volume discount (“**retroactive accumulative discount**” or “**RAD**”) and 2) customized volume target discount (“**target discount**” or “**TD**”). RAD refers to a discount that is granted on all units purchased if a customer’s purchase

volume during a defined reference period exceeds a certain threshold. TD is a discount that is customized for individual customers and is granted on the condition that a customer's purchase volume during a defined reference period meets or exceeds the target percentage or a customized volume target.

The SAIC found that loyalty discounts have a loyalty inducing effect. Specifically, in the case of RAD, given that the discount applies to all units purchased during a defined reference period, when a customer's purchase volume reaches the threshold, the price that the customer needs to pay drops significantly. Therefore, to obtain more products at a lower price when a customer's purchase volume approaches the threshold, customers tend to continue purchasing until the threshold is met, which leads to a loyalty inducing effect. In the TD scenario, the business operator with dominant market position tends to condition its discount on the target percentage and volume target set forth specifically for individual customers, the direct consequence of which would be to lock-in the customer's purchase percentage or volume. In that sense, TD also has a loyalty inducing effect.

By taking into account specific market conditions, the SAIC found that TP's loyalty discount had evident anti-competitive effects. Specifically, firstly some of TP's customers rely on TP's wide range of product categories and its production capacity, and therefore such reliance constitutes a "non-contestable portion of demand"⁷ of customers for TP products. Secondly, resulting from TP's tying arrangement during its provision of machinery and technical services, part of the "contestable portion of demand"⁸ has been locked-in to become a "non-contestable portion of demand", and thereby the "non-contestable portion of demand" is enlarged. Thirdly, the use of multiple discounts by TP further enlarges "non-contestable portion of demand" through a loyalty inducing effect, which turned the "contestable portion of demand" into a "non-contestable portion of demand" and consequently squeezed out the contestable spaces of other carton manufacturers. Therefore, loyalty discounts allowed TP to restrict and affect the "contestable portion of demand" by taking advantage of the "non-contestable portion of demand", and leveraging TP's market power on the "non-contestable portion of demand" to the "contestable portion of demand".

Following on from this, the SAIC further analyzed whether loyalty discounts affected competition in the carton market. The SAIC found that in order to compete with TP, competitors have to match TP's price by providing larger discounts to attract clients to switch to them. Such discount provided by other competitors not only needs to be no less than TP's for "contestable portion of demand", but also must be able to compensate customers' loss of retroactive discount for "non-contestable portion of demand" due to their reduced purchase from TP. The SAIC concluded that therefore in the situation where the contestable portion of demand is rather limited as in this case, other competitors' prices must be lowered enough to match TP's, thus making it more difficult for other competitors to compete with TP who may even be forced to abandon competition. Competitors would then be foreclosed and the market competition would be eliminated or restricted. The SAIC determined that TP's loyalty

⁷ "Non-contestable portion of demand" refers the portion of demand that can only be satisfied by dominant market players due to the clients' reliance on their product categories and production capacities.

⁸ "Contestable portion of demand" refers to the portion of demand that can be satisfied by both dominant market players and other market players simultaneously.

discount scheme constitutes “other forms of abuse of dominant market position” as prohibited by Article 17(1) vii of the AML.

Points to note:

- The SAIC’s determination of loyalty discounts as abusive behavior under certain market conditions is consistent with commonly held opinion and antitrust practice in many other jurisdictions. Loyalty discounts are not per se illegal, and in fact competition authorities of many countries regard loyalty discounts as legitimate pricing arrangements, and recognize their pro-competitive effects that could allow clients and consumers to share the benefits of lower prices. Only in cases where loyalty discount reached the degree of “exclusive dealing” (concerning single-product retroactive accumulative discount⁹ and target discounts under EU law), “tying and bundling” (concerning multi-product retroactive accumulative discounts¹⁰ analyzed from the perspective of “multiple product rebates” under EU laws) or “predatory pricing” (concerning single-product retroactive accumulative discount under US law) will competition authorities step in and regulate loyalty discounts. As the NDRC has provided in Regulations of Anti-Price Monopoly¹¹ issued in 2010, a business operator’s price discount may achieve the effect of exclusive dealing.
- In comparison with RAD, the SAIC in its decision specifically mentioned that in the case of incremental discounts, price discounts would only apply to the volume that exceeds the threshold and regardless of the purchase volume, the price for one extra unit will never be zero or of negative value. In that regard, incremental discounts have relatively weak loyalty inducing effect to customers, and thus bear lower legal risks under AML.

V. Conclusion

As a landmark case of antitrust enforcement in recent years, this case involves almost five years of enforcement efforts, complicated facts and legal issues. In its 47-page penalty decision, the SAIC combines professional technologies, economics and laws in its studies and researches. This demonstrates the cautious and thoughtful approach taken by the SAIC. Notably, this case is the first case where the SAIC puts Article 17(1) (vii) of the AML into enforcement, regulating “loyalty discount” as “other forms of abusing the dominant market position as determined by the Anti-Monopoly Enforcement Authorities under the State Council”. This embodies both theoretical and practical significance for antitrust enforcement, and also provides valuable guidance to business operators’ in their compliance efforts.

⁹ Single-product retroactive accumulative discount refers to a RAD that is granted based on the purchase of a single type of product.

¹⁰ Multi-product retroactive accumulative discount refers to a RAD that is granted based on the purchase of two or more types of products.

¹¹ Article 14 of Regulations on Anti-Price Monopoly provides that, business operators with a dominant market position are prohibited from restricting their trading party through methods of such as providing price discount to deal exclusively with them or with the designated business operators without justifiable reasons.