

# THE *TETRA PAK* CASE: ARE LOYALTY REBATES TREATED DIFFERENTLY BY THE CHINESE ANTITRUST REGULATOR?



BY MICHAEL HAN, ANDREW SKUDDER & DAVID BOYLE<sup>1</sup>



## I. INTRODUCTION

On November 16, 2016, the State Administration for Industry and Commerce of the People's Republic of China ("the SAIC") published its penalty decision against Tetra Pak, a multinational food packaging and processing company. Following a thorough investigation lasting more than four years, the SAIC imposed a fine of USD \$97 million on Tetra Pak after concluding the food packaging company had abused its dominant market position in the liquid food aseptic carton packaging industry from 2009 to 2013 in breach of China's Anti-monopoly Law ("AML"). The alleged abuses involved not only the sales of packaging equipment, but also the repair services and raw materials markets. The detailed 47-page published decision highlights some interesting developments regarding the Chinese competition regulator's enforcement against abusive conduct, which in the past was considered a much more complex and less prioritized area compared to hardcore antitrust infringements such as cartels.

In particular, the SAIC's decision in relation to Tetra Pak's loyalty rebates scheme is noteworthy since it is the first time a Chinese antitrust enforcer has considered loyalty rebates offered by a dominant firm to be a violation of the AML (especially in light of the fact that loyalty rebates are not explicitly listed as an antitrust violation and, for the first time, the SAIC invoked its discretionary power under the catch-all provision of the AML to reach its own findings). Indeed the granting of such rebates by dominant firms is a hot topic for many antitrust enforcement agencies globally. In 2009, the European Commission ("Commission") imposed a record fine of EUR 1.06 billion on Intel for its conduct, including awarding rebates to computer makers. The Commission's decision was upheld by the European General Court and is currently under appeal to the European Court of Justice. The decision of the Court of Justice will no doubt provide welcome guidance on when such practices can fall foul of European competition law.<sup>2</sup>

In this article, we will focus on the SAIC's findings that Tetra Pak's loyalty rebates schemes amounted to an abuse of dominance<sup>3</sup> and compare and contrast this to the approach taken by the Commission in the *Intel* case.

<sup>1</sup> Michael Han and Andrew Skudder are antitrust partners at Fangda Partners. David Boyle is an antitrust associate in the Hong Kong office of Fangda Partners.

<sup>2</sup> In October 2016, the Advocate General to the Court of Justice released his non-binding decision in which he recommended the General Court's decision be overturned on a number of grounds including that the General Court erred in law in its alternative assessment of capability by refusing to establish that the rebates and payments offered by Intel had in all likelihood an anti-competitive foreclosure effect.

<sup>3</sup> The SAIC also found that Tetra Pak had abused its dominant position by tying sales and imposing exclusive supply obligations on trading partners.

## II. TETRA PAK'S DOMINANT POSITION

In its decision, the SAIC identified three separate and independent relevant product markets; the Carton Equipment Market, the Technological Services Market and the Carton Packaging Material Market. In each of the three relevant markets, the SAIC determined that Tetra Pak held a dominant market position on the basis of four main criteria: (i) respective market shares and market structures, (ii) Tetra Pak's ability to control the market (iii) reliance of other business undertakings on Tetra Pak, and (iv) difficulty of market entry for competitors.

On the basis that Tetra Pak had a dominant position in the three relevant markets, the SAIC then investigated whether the rebates Tetra Pak offered to its customers had the effect of restricting competition and foreclosing competitors.

## III. THE SAIC'S ANALYSIS OF TETRA PAK'S LOYALTY REBATES AND TARGETED DISCOUNTS

The offering of discounts or rebates to customers is normally considered part of everyday business life and generally such activities do not raise competition law concerns, rebates generally stimulate demand and benefit consumers by lowering the price. However, loyalty rebates when offered by a dominant firm can raise competition law concerns since customers purchase only (or in a large part) from the dominant undertaking, which forecloses the dominant firm's competitors.<sup>4</sup> In particular, retroactive rebates (i.e. those applying to all purchases once a certain purchase threshold is met) offered by a dominant undertaking are considered of greater concern from a competition law perspective since they can foreclose the market by making it less attractive for customers to switch even small amounts of orders to another supplier since they would lose the retroactive rebate if they do so.

Although loyalty rebates, or rebates in general, have not been explicitly defined or prohibited by the AML, they can potentially still fall under Article 17 of AML which covers "other abuses of dominant market positions as determined by the antitrust enforcement agencies" (the so-called "catch-all provision"). It is worth noting that prior to the Tetra Pak case, as far as we are aware, none of the Chinese antitrust agencies had applied this "catch-all provision" to sanction other antitrust infringements.

In its analysis, the SAIC considered two main elements of Tetra Pak's discounting scheme ( i ) retroactive loyalty rebates, and ( ii ) customized volume targeted rebates:

- *Retroactive loyalty rebates:* Retroactive loyalty rebates, as defined by the SAIC, refer to discounts offered retroactively on a customer's cumulative purchases when the total purchased volume reaches a certain threshold for a certain period of time. Under Tetra Pak's retroactive discount scheme, customers were offered discounts in accordance with pre-set thresholds based on the total volume of packaging material they purchased from Tetra Pak in a given year. In addition, Tetra Pak offered additional rebates based on a customer's purchase of two or more types of packaging material.
- *Customized volume-target rebates:* Volume target rebates amount to a straight discount on orders. Under Tetra Pak's target rebates scheme, discounts were offered to customers based on the condition that the products purchased by a specific customer in a certain period should reach or exceed a target percentage or specific fixed volume. Tetra Pak's target discounts were usually tailored by Tetra Pak according to the specific customer.

The SAIC considered that it was not only Tetra Pak's retroactive rebates which were of concern but also any form of targeted rebates offered by Tetra Pak since those also had the effect of inducing loyalty to Tetra Pak and foreclosing its competitors.

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<sup>4</sup> Loyalty or fidelity rebates are discounts offered to customers which are conditional on targets being met by the customer or which induce other loyalty or fidelity type behavior towards the dominant undertaking.

## A. Key Points from the SAIC's Analysis of Tetra Pak's Rebate Schemes

The SAIC considered that Tetra Pak's retroactive rebate schemes could induce customers to stay loyal to Tetra Pak and therefore foreclose Tetra Pak's competitors. The retroactive rebates were considered to differ from other types of volume discounts based on their "retroactivity" and "cumulateness" in volume which induced customers to purchase as many products as possible in order to reach the thresholds and enjoy higher discounts.

Regarding volume targeted rebates, the SAIC considered that the direct effect of Tetra Pak's targeted discounts was to "lock-in" a customer's demand with respect to the percentage or volume of purchases. Therefore, the targeted rebates also had the effect of inducing loyalty and foreclosing Tetra Pak's competitors. The SAIC found that both the retroactive rebates and volume targeted rebates foreclosed competitors in the market.

In finding that Tetra Pak's rebates schemes constituted a violation of the AML, the SAIC relied on the transaction statistics, sales arrangements between Tetra Pak and its customers as well as economic modelling. In particular, the SAIC focused on "contestable" and "non-contestable demand" in the relevant markets.<sup>5</sup> The loyalty rebates offered by Tetra Pak meant that it could leverage its position in relation to non-contestable demand to the contestable demand segment of the market.

The SAIC identified specific factors in this case which meant Tetra Pak could leverage its power to the contestable demand segment. Those factors included:

- Some customers had a reliance on Tetra Pak's products, in fact some products could only be provided by Tetra Pak. The fact that some customers had a reliance on Tetra Pak's capacity in terms of some products was seen as the critical factor which enabled Tetra Pak to create non-contestable demand.
- Tetra Pak tied the sales of packaging materials with supplying equipment and technological services. This effectively locked a portion of contestable demand and converted it to non-contestable demand.
- Tetra Pak used its various discount schemes in a cumulative manner. For example, the targeted discounts were able to lock-in the purchases of a specific customer and convert this previously contestable demand into non-contestable demand.

In its analysis, the SAIC relied on sophisticated economic models and theories to show that the various rebates offered by Tetra Pak had the effect of inducing loyalty. Tetra Pak's loyalty discounts forced its competitors to offer lower discounts not only to match Tetra Pak's price but also to "compensate" for the loss of a retroactive or cumulative rebate should a customer switch from Tetra Pak. The SAIC acknowledged that lower prices are to be welcomed in the short run, however in the long run, those loyalty discounts restricted sales volume and profits of other packaging materials manufacturers, leading to inadequate capacity utilization rate, and restricted survival and development, which adversely influenced competition in the market and the interests of customers.

## IV. COMPARISON WITH THE COMMISSION'S APPROACH

The SAIC's decision in relation to Tetra Pak's loyalty rebates marks the first time a Chinese antitrust agency has punished a dominant firm for such conduct. The decision brings the Chinese agencies in line with other jurisdictions, such as the EU, who have previously made some high-profile decisions in this area. While there are some similarities in the Chinese and European agencies approach to loyalty rebates, the Tetra Pak decision also highlights some differences.

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<sup>5</sup> According to economic theory, for a dominant firm, its demand can be divided into contestable and non-contestable demand. The non-contestable demand can only be met by the dominant firm, whereas the contestable demand can be met by the dominant firm or its competitors.

## A. The Legal Framework in China and the EU

The legal framework regarding an abuse of a dominant position in Europe is similar to that in China. Under Article 102 TFEU (Treaty on the Functioning of the European Union), a dominant undertaking can be found to have abused its dominant position where it offers discounts or rebates to a customer which forecloses competitors and results in consumer harm. The offering of rebates is not specifically stated as an offence under Article 102, but the European Courts have established that in certain instances it can amount to an offence. Similarly, loyalty rebates are not specifically mentioned in the AML, however the AML has a catch-all provision regarding abuse of dominance which means that conduct not expressly stated in the AML can still be considered a breach of China's antitrust law.

## B. Comparison with the EU's Approach

The most recent high-profile case in Europe in relation to rebates is the Commission's investigation into Intel. The Commission found that Intel abused its dominant position in relation to "x86 Central Processing Units" ("CPUs") by (i) giving rebates to computer manufacturers on the condition that they purchase all or most of their CPU requirements from Intel and (ii) paying Original Equipment Manufacturers ("OEMs") to delay the launch of products which would compete with Intel's CPUs.

In the appeal of that decision, the General Court made a distinction between three types of rebates:

1) *quantity rebates*: the discount is linked to the volumes of sales of a customer (but not customized)

2) *exclusivity rebates*: the discount is conditional on the customer buying exclusively or almost exclusively from the dominant undertaking; and

3) *other category rebates*: a general category catching discounts which are neither quantity rebates nor exclusivity rebates.

While not all discounts offered by a dominant undertaking should be considered abusive (objective quantity discounts, for example), the rebates offered by Intel were given in return for loyalty or exclusivity and were considered *per se* illegal by the Commission. The General Court agreed with the Commission and considered exclusivity rebates to be presumptively unlawful unless objectively justified, therefore there was no need to prove actual anti-competitive effects.<sup>6</sup> However, in relation to the third category of rebates outlined above, the general position in the EU is that a "rule of reason" approach is required when analyzing such rebates, therefore it is necessary to assess whether the rebates have an anti-competitive effect before determining whether third category rebates are unlawful.

The two types of rebates in the *Tetra Pak* case investigated by the SAIC would likely fall under this third "other category" of rebates if the case were investigated in Europe, since Tetra Pak's rebate schemes did not require exclusivity and were not conditional on customers purchasing all or most of their requirements from Tetra Pak.<sup>7</sup> Such third category rebates are not considered presumptively unlawful and therefore the Commission would need to consider the anti-competitive effects of those rebates if the case were investigated in Europe. This is similar to the approach the SAIC has taken. In particular, the SAIC seems to have taken a rule of reason based approach towards Tetra Pak's loyalty rebates, relying heavily on economic analysis of the anti-competitive effects of such rebates.

While it appears that the SAIC has taken a rule of reason approach in this case, it is unclear whether Tetra Pak raised any justifications or pro-competitive arguments, or indeed whether the SAIC would consider any pro-competitive justifications since this is not discussed in the published decision. When analyzing such third category rebates, it is likely that the European Commission would consider any pro-competitive arguments put forward by the dominant undertaking and outline its assessment of those arguments in its decision.

<sup>6</sup> The Advocate General's recent non-binding opinion concludes that the General Court erred in finding that 'exclusivity rebates' constitute a separate and unique category of rebates that require no consideration of all the circumstances in order to establish an abuse of dominance.

<sup>7</sup> The published decision does not discuss whether the SAIC considered Tetra Pak's rebates effectively amounted to *de facto* exclusivity rebates even though Tetra Pak did not explicitly require exclusivity and the rebates were not conditional on customers purchasing all or most of their requirements from Tetra Pak.

The lack of discussion on justifications in the SAIC's decision may imply that the SAIC does not consider pro-competitive justifications when investigating loyalty rebates offered by a dominant firm. Alternatively, the SAIC may have considered economic arguments put forward by Tetra Pak but redacted this information from the final decision. It is not uncommon for an authority in China to redact economic arguments raised by parties in the final published decision.

In determining whether Intel's conditional rebate schemes were illegal, the Commission used the "as efficient competitor test." This is a hypothetical test to analyze whether a competitor as efficient as the dominant undertaking, but which seeks to supply a product not as broadly as the dominant undertaking, would be foreclosed from competing.<sup>8</sup> The Commission found that in order to compensate an Intel customer for the loss of Intel's conditional rebates, an as efficient competitor would have had to price its CPUs below average avoidable cost, which meant even an as efficient competitor was foreclosed from competing with Intel.

The SAIC's decision does not expressly state which economic theory or test it used in its analysis. It is unclear whether the SAIC considered the "as efficient competitor" test and/or took elements from the "raising rivals cost" theory when concluding that Tetra Pak's rebates were anti-competitive. While it might be true that Tetra Pak's competitors would always have to provide similar rebates or lower prices in order to compete with Tetra Pak's rebate schemes, if Tetra Pak's competitors were not as efficient competitors as Tetra Pak, it would be difficult to argue that they were excluded from competing simply because of Tetra Pak's rebate schemes. One has to always bear in mind that the mere elimination of a particular rival does not necessarily mean there will be any harm to competition or consumers, as the elimination may be the result of genuine competition and the rival may not be an efficient competitor.

In addition, a low price can exclude competitors if they are below a certain cost benchmark. However, the SAIC's decision does not indicate what cost measurement should be used in such an analysis or how those costs should be calculated. It is unclear whether the SAIC would consider average avoidable cost as the benchmark in future cases.

With regard to the target rebates, according to case law and the Commission's practice, whether a target rebate is problematic will depend *inter alia* on the length of the reference period upon which the rebate is calculated and on the degree to which the criteria for granting the rebate are objective and transparent. For example, in the *Michelin I* case in the EU, in finding the rebate abusive, the General Court placed particular emphasis on the length of the reference period (one year), pointing out that customers would be unlikely to switch suppliers at any point during the year before qualifying for the rebate. The Court also relied, though to a lesser degree, on the secret manner in which the rebates were agreed, and the general lack of uniformity and transparency of the rebate scheme. In the *Tetra Pak* case, the fact that the SAIC found the customized volume-target rebates abusive seems to suggest one of the factors the SAIC might have also considered was the lack of uniformity and transparency of the rebate scheme. It is difficult to ascertain from the published decision what exact factors (e.g. the duration of the scheme) the SAIC took into consideration in reaching its conclusion.

Overall, the SAIC's general rule of reason approach to rebates is to be welcomed. While it appears evident that Tetra Pak's rebates were classified as those types of rebates which require a rule of reason analysis, it is unfortunately less clear what factors the SAIC considered in such analysis.

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8 In upholding the Commission's decision, the General Court held that it was unnecessary for the Commission to conduct any as efficient competitor test or carry out any cost/price analysis to reach a finding that exclusivity rebates were abusive. This point is currently under appeal to the Court of Justice.

## V. CONCLUSION

Antitrust agencies are particularly concerned with retroactive rebates offered by dominant undertakings, whereas other types of less foreclosing rebate schemes are generally considered easier to justify given their pro-competitive effects (such as stimulating demand and benefitting consumers). However, the SAIC's approach seems to focus on not only retroactive loyalty rebates but also on any form of targeted rebates offered by Tetra Pak. Further discussion, or more specific guidance, on the rebates issue would be particularly useful so that companies at or approaching dominance have a clearer understanding of how they should organize their behavior so as to remain AML compliant.

The *Tetra Pak* decision marks the first time the Chinese authorities have punished loyalty rebates and the SAIC's published decision shows an increased sophistication in its investigations. The increased use of economic models and theories outlined in the decision and the publication of a detailed 47-page decision is to be welcomed. While it would be helpful if the SAIC elaborated on some aspects of its analysis, the publication of such detailed decisions by the SAIC is a positive move which will no doubt provide useful guidance for companies and their advisors.

