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Unpacking China's SAIC *Tetra Pak* decision

THE FIRST SAIC LANDMARK DECISION AGAINST A FOREIGN COMPANY

On 9 November 2016, the State Administration for Industry & Commerce (the **SAIC**) – the Chinese antitrust authority in charge of non-price-related conduct – imposed a record penalty of CNY 677.7m (approximately USD 97m) on Swiss packaging giant Tetra Pak for abuse of dominant position pursuant to Article 17 of China's Anti-Monopoly Law (the **AML**). This ended an almost four-year investigation and is the highest antitrust fine ever imposed by the SAIC to date.

This is the first high-profile antitrust case concluded by the SAIC against a multinational company. It confirms that the SAIC is determined to tackle complex antitrust infringements and casts light on the SAIC's position on various forms of abuse of dominance, such as bundling, exclusive dealing and loyalty discounts.

It is also the first case of application of the catch-all provision of Article 17.7 of the AML, which leaves a wide margin of discretion to the Chinese agencies by allowing them to target conduct that is not specifically mentioned in Article 17 as being potentially abusive.

OVERVIEW OF THE DECISION

The SAIC found that Tetra Pak International and five of its subsidiaries (collectively referred to as **TP**) held a dominant position in three markets in China: the markets for equipment, technical services, and packaging material for paper-based composite aseptic packaging of liquid food. Between 2009 and 2013, Tetra Pak abused its dominant position in these markets through three types of anti-competitive conduct: bundling, exclusive dealing, and loyalty discounts.

Bundling

The SAIC found that TP bundled packaging material with the provision of packaging equipment and technical services, in particular by imposing the following requirements:

– TP's packaging equipment could only be used with TP's packaging material, or packaging material of an equivalent quality, during any start-up period (up to 12 months from the first use of the packaging equipment). After 2012, TP allowed packaging equipment to be used with packaging material that met the minimum specification standardsit had defined.

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- TP would provide fixed-cost maintenance services only if TP's packaging equipment was used exclusively with the packaging material and spare parts provided by TP. However, in 2011, TP voluntarily removed this requirement.

According to the SAIC, there was no valid reason to force users to use TP's packaging material exclusively as a prerequisite for the normal operation of TP's packaging equipment and the provision by TP of maintenance services. The bundling requirements thus damaged competition in the packaging material market without justifiable reason and infringed Article 17.5 of the AML.

Exclusive dealing

Raw paper is an important element in the production of packaging material. Hua Xin Packaging Co. and its subsidiaries (collectively referred to as **HXP**) are the only company group in China capable of supplying high-end raw paper, i.e. kraft back paper (**KBP**). The SAIC found that TP had required HXP to supply its KBP exclusively to Tetra Pak, imposing the following restrictions on HXP:

- HXP was prohibited from cooperating with any other packaging producer in relation to KBP;
- HXP was restricted in its use of TP's technical data. In particular, the 2012 supply agreement between TP and HXP provided that:
  - HXP could not use any TP technical information unless it was for the purpose of producing products for TP; and
  - HXP could not sell or supply products produced on the basis of TP's technical data[1] to any third party, and could not assist any other party to do so.

The SAIC found that HXP had proprietary patents for producing KBP, which were not provided or licensed by TP. The provision of KBP to third parties would not have had an impact on the cooperation between HXP and TP, because raw paper could be customised in accordance with the various specifications provided by different clients, without incurring additional cost. In addition, the technical data on which TP imposed restrictions for HXP's use was not exclusively owned by TP. As HXP could not produce quality KBP without using such technical data, restrictions on the use of technical data *de facto* prohibited HXP from supplying KBP to any third party. Therefore, the SAIC held that the exclusive dealing damaged competition in the packaging material market without justifiable reason and infringed Article 17.4 of the AML.

Loyalty rebates

The SAIC found that between 2009 and 2013 TP provided multiple rebates for the packaging material business, some of which constituted anticompetitive loyalty rebates.

- Retroactive and accumulative rebate (**RAR**)

  Based on the SAIC definition, a RAR is a rebate scheme by which a customer is given a **retroactive rebate** on all purchases if its purchases exceed a certain volume over a certain period, and the **percentage of the rebate increases** with the increase in purchases. The SAIC found that such rebates were the core of TP's rebate system and comprised two types: annual single-product RAR and annual multiple-product RAR.

- Individualised target rebate

  In some cases, rebates were calculated as a percentage of purchase targets defined on an individual customer basis.

The SAIC found that TP's loyalty discounts damaged competition in the packaging material market without justifiable reason and therefore infringed Article 17.7 of the AML. In particular, the SAIC found that TP's loyalty rebates had an anticompetitive loyalty-inducing effect, because the total amount payable would decrease rather than increase when purchases exceeded a certain volume. This induced customers to purchase more than they would have in the absence of the rebates.

The SAIC also found that TP leveraged the non-contestable[2] demand (on the equipment and service markets) to restrict and harm competition on the contestable part of the demand (on the packaging material market), in particular through the bundling requirements and the loyalty rebates.

MAIN TAKE-AWAYS FROM THE *TETRA PAK* CASE

Drawing a line between fair competition and the abuse of a dominant position has never been easy. In most jurisdictions, an effect-based (or rule-of-reason) approach has been adopted. Whether there are justifiable reasons is usually also an important element in the analysis.

The SAIC's 47-page decision adopts an "effect-based" approach and provides a comprehensive analysis of why TP's conduct was anticompetitive and could not be justified on objective grounds. The decision constitutes welcome guidance for companies in a dominant position.

1 TP's data includes: (i) TP's technical data in relation to product specifications; and (ii) technology processing data.

2 In general, demand can be divided into "non-contestable" and "contestable" demand. It is "non-contestable" where only the dominant company can provide the relevant goods or services. It is "contestable" whether third parties can compete with the dominant company.

Can a producer require that original inputs/accessories be used?[3]

It is not uncommon for a producer to impose restrictions on the use of inputs (e.g. packaging material) or accessories (e.g. auto parts) for the purpose of a product quality warranty. In particular, producers usually require that as a condition of the warranty, the original inputs/accessories – or inputs/accessories of equivalent quality to the original – must be used during the warranty period. Not only were there such requirements in the TP case, but such requirements are also very common in other industries.

There are no specific rules in China on when a producer can require that OEM input/accessories be used with the product that it supplies. However, the SAIC's conclusions and analysis in the *Tetra Pak* case has shed more light on this issue:

- A requirement to use OEM or equivalent inputs/accessories will likely be anticompetitive if their use is not a prerequisite for the normal operation of the product. The SAIC found that TP's packaging equipment could also meet the relevant performance standards if alternative packaging material were used.
- A requirement to use OEM or equivalent inputs/accessories will likely be anticompetitive if it is not in line with industry practice. The SAIC found that it is industry practice that equipment will pass performance verification as long as the equipment meets the relevant national standards. This seems to imply that if there are national or industrial standards in place, no requirement to use certain inputs/accessories should be imposed unless the company imposing the requirement can prove that it is not industry practice to follow the national standards.
- Determining whether an input or accessory is of equivalent quality to the OEM one should not be left to the producer's discretion. Evaluation criteria and the relevant specifications of the OEM input/accessory should be made available to third parties. The SAIC found that TP's customers could not actually purchase packaging material of equivalent quality from third parties because the specifications for the original material were proprietary TP information generally not available to customers. Even if the customers could get the relevant standards/specifications from TP, whether the third parties' material was of equivalent quality remained for TP to decide.
- The limited period of the requirement to use certain inputs/accessories (e.g. during the warranty period only) may not be enough to render it lawful. The SAIC found that once the equipment has been tuned for use with certain packaging material, customers have to pay more to re-set the equipment if they want to use alternative packaging material. This would in practice constitute a barrier for customers to shift from TP's to a rival's material.
- The allocation of liability between various vendors in case of quality concerns does not justify a requirement to use OEM or equivalent inputs/accessories. In the investigation, TP had argued that if packaging material were provided by a third party, it would be impossible to identify who (TP or the third party) should be responsible for quality concerns. The SAIC, however, found that using a rival's packaging material would not necessarily prevent identifying where and why the quality issue arose. The division of responsibilities between the different suppliers of packaging material, equipment, and liquid food is clear, thereby making the bundling requirement unnecessary.

Exclusive dealing – customers' exclusive supply obligations

The *Tetra Pak* decision confirmed that a dominant company entering into an exclusive-dealing arrangement (including exclusive purchasing and exclusive supply) without an objective justification runs a real risk of being in breach of Article 17 of the AML. In particular, it set outs the following principles which the SAIC will adopt when assessing exclusive-dealing scenarios:

- The fact that a trading party's capacity production is under-utilised as a result of an exclusivity provision constitutes evidence that such exclusivity provision is anticompetitive.
- Where a product should meet certain technical specifications, a dominant company cannot prevent third parties from selling products that are reliant on technical data owned by others or already in the public domain.

3 Strictly speaking, packaging material is not an accessory to the packaging equipment. However, there is a strong analogy between these two because both of them are an indispensable part of maintaining the proper operation of the main product (e.g. the equipment). As restrictions on the use of accessories are more common in practice, we expand our discussion to a broader context, i.e. input and accessories.

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How to structure rebate schemes?

Rebates are a very common form of price competition and are lawful when offered unilaterally by a non-dominant company. However, the characteristics of rebates schemes that a dominant company may design to incentivise its customers are highly controversial – even in the EU and the U.S.

The *Tetra Pak* decision is the first case in which a Chinese antitrust authority has comprehensively analysed a dominant company's loyalty rebate and found a breach of Article 17 of the AML, despite the fact that loyalty rebates are not specifically targeted by the text of Article 17.

The SAIC focused on the retroactive rebates and the individualised target rebates. In its analysis, the SAIC adopted the approach taken in the EU – an effect-based approach – and used an economic test in its assessment. In particular, the SAIC adopted the following key principles:

– The likelihood of anti-competitive foreclosure is higher where competitors are not able to compete on equal terms for the entire demand of each individual customer (e.g. because dominant undertakings use the non-contestable portion of the customer's demand as leverage to reduce the price for the contestable portion of demand).

– The rebate percentage and the retroactive threshold play an important role in determining the loyalty rebate. The higher the rebate as a percentage of the total price and the higher the threshold, the greater the loyalty-inducing effect and the stronger the likely foreclosure effect.

– The SAIC estimates the price that a rival would have to offer to compensate a customer for the loss of the loyalty rebate if the customer were to take part of its business away from the dominant company. The relevant price will usually be the dominant undertaking's normal list price minus the rebate that the customer would lose by switching.

– The SAIC considers the argument that a dominant company's rebate systems may achieve cost or other advantages, which are passed on to consumers. In the *Tetra Pak* decision, however, the SAIC concluded that the anti-competitive effect of TP's loyalty rebates outweighed the benefits passed on to consumers.

Interestingly, the SAIC did not provide a quantified comparison between the effective price that the competitor would have to match and the costs of the dominant company (i.e. TP). This is different from the European Commission's approach. In general, the European Commission will compare the effective price with the costs of the dominant company. As long as the effective price remains consistently above the dominant company's LRAIC (long-run average incremental cost), an equally efficient competitor can normally compete profitably, irrespective of the rebate. In those circumstances, the rebate will not normally hamper or limit competitors' effective access to supplies or markets. It is not clear whether the Chinese antitrust authorities will make a similar assessment in future proceedings relating to loyalty rebates. As is the case in Europe, the *Tetra Pak* case is expected to be the first in a long series of decisions on rebates to be issued by the Chinese competition authorities.

Moreover, the SAIC has clearly signaled through the *Tetra Pak* decision that it is determined to make a thorough analysis of sophisticated theories of harm and capture all forms of anticompetitive conduct by a dominant company, irrespective of whether such conduct is expressly mentioned in Article 17 of the AML.

Your Key Contact Persons in China

Charles Pommiès
Counsel
Beijing
Tel +86 10 6535 4360
charles.pommies@allenovery.com

François Renard
Registered Foreign Lawyer, BEL
Hong Kong and Beijing
Tel +852 2974 7110 (Hong Kong)
+86 10 6535 4359 (Beijing)
francois.renard@allenovery.com

Jie Tong
Senior Associate
Beijing
Tel +86 10 6535 4354
jie.tong@allenovery.com

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