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ROUNDTABLE ON FIDELITY REBATES

Note by Chinese Taipei

15 – 17 June

This document reproduces a written contribution from Chinese Taipei submitted for item 6 of the 125th OECD Competition committee on 15-17 June 2016.

More documents related to this discussion can be found at www.oecd.org/daf/competition/fidelity-rebates.htm

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This report illustrates the application of the Fair Trade Act (FTA) to fidelity rebates (loyal discount) in Chinese Taipei, and the Fair Trade Commission's (FTC) approach to handling such cases with a case example.

1. Chinese Taipei's Investigation on "Fidelity Rebates" or "Loyalty Discounts"

1. The Fair Trade Act (FTA) of Chinese Taipei does not have specific provision to define or regulate the term "fidelity rebates" or "loyalty discounts." When handling cases in practice, the FTC usually uses the term "loyalty discounts" or "fidelity discounts" to describe the practices of offering lower prices or other preferential treatment by enterprises to trading counterparts (including intermediate traders and end users) for continuing transactions with the enterprise and not switching to other competitors.

2. When handling cases related to loyalty discounts that may lead to restricted competition, the FTC generally applies Paragraph 3 of Article 20 of the FTA: "No enterprise shall engage in any of the following acts that is likely to restrain competition:...3. preventing competitors from participating or engaging in competition by inducement with low price, or other improper means." According to Article 27 of the Enforcement Rules of Fair Trade Act (Enforcement Rules): "The 'low price inducement' described in Subparagraph 3 of Article 20 of the Act refers to the offering of prices below costs or obviously inappropriate so as to hinder competition or prevent competitors from participating in the market. In determining whether the low price inducement mentioned in the preceding paragraph is likely to restrain competition, the totality of such factors as the intent, purposes, and market position of the parties, the structure of the market to which they belong, the characteristics of the goods or services, and the impact that carrying out such restrictions would have on market competition shall be considered." Moreover, if the loyalty discount is offered by a monopolistic enterprise, Subparagraph 1 of Article 9 of the FTL: "directly or indirectly prevent any other enterprises from competing by unfair means;" may be applied.

3. That is, when handling "loyalty discount" cases, the FTA first considers whether the discount hinders competition by offering prices below cost or obviously inappropriate. Hence, the approach to handling loyalty discount cases essentially includes using "low price inducement" to cause "predatory pricing" effects, and thereby prevent competitors from participating in the market. If the loyalty discount does not result in predatory pricing but may restrict competition by "market foreclosure," the conditions listed in Article 27 of the Enforcement Rules must be considered, i.e., the overall effects of intent, purposes, and market position of the parties, the structure of the market to which they belong, the characteristics of the goods or services, and the impact that carrying out such restrictions would have on market competition shall be considered to determine the case.

4. In fact, the FTC recognizes the competitive effects caused by price discounts in the market and their benefits to consumers. The effects of "low price inducement" that the FTC is concerned about are the actions taken by enterprises to prevent competitors from participating in the market, which includes the intent to foreclose the market so that existing competitors cannot continue to compete with the enterprise, or to prevent potential competitors from entering the market. The FTC believes that the conduct is not only harmful to the interests of competitors and consumers, but may also hinder market function in the mid- to long term. Furthermore, enterprises capable of using low price inducements must have considerable financial resources, and usually have a certain level of market power to engage in improper conduct to restrict market competition. When low price inducement by enterprises with considerable market power does not result in predatory pricing, it will still restrict market competition to a certain extent, and must therefore be appropriately regulated.

5. Assessing the Effects of Loyalty Discounts

6. Most "loyalty discounts" cases in Chinese Taipei are in the telecommunications and cable TV industries. The FTC explains the conduct of "anti-competition discount offers" in Item 8 of the Fair Trade Commission Disposal Directions (Policy Statements) on the Telecommunications Industry (the Policy

statement): “It is a common practice in competitive markets for enterprises to generate trading opportunities with discount offers and this type of practice usually calls for no particular regulation. However, certain discount offers, such as selective discounts, loyalty discounts and deferred discounts, may create a negative impact on market competition and become anti-competition practices. Such conduct may be considered as being in violation of ‘causing the trading counterpart(s) of its competitors to do business with itself by inducement with interest,’ in Subparagraph 3 of Article 19 of the Fair Trade Act.”

7. The term “loyalty discounts” then is defined in the Policy Statements as follows: “This refers to discount offers to subscribers under the condition that the subscribers do not switch to different providers or large discounts given to subscribers with the potential to switch to other providers to prevent loss of customers. Such discounts may result in subscribers being ‘locked out’ by specific enterprises and thus obstruct their competitors from gaining trading opportunities.”

8. That is, to attract consumers to use their services on a long-term basis, telecommunications enterprises often adopt offers of volume discounts or fixed-term subscription contracts to obtain trading opportunities. Telecommunications enterprises usually offer discounts to subscribers who agree to use a certain amount of services or to a certain call charge amount or use the services for a certain period of time. If the subscribers fail to fulfill the promised level of call amount or charges or decide on early contract termination, they will be held liable for an “exit payment” as compensation to the telecommunications enterprise. Since the exit payment mechanism can increase subscribers’ switching costs and obstruct competitors from gaining trading opportunities, it may constitute offering anti-competition discounts. When assessing the justifiability of the aforesaid loyalty discounts, the FTC will evaluate the following:

1. Whether subscribers have been given enough options before signing the contract;
2. The duration of the contract period;
3. The costs to telecommunications enterprises of providing the services;
4. The recoverable percentage of the aforesaid costs within the contract period;
5. Whether the amount of the exit payment exceeds the total discounts subscribers have received before withdrawal;
6. Whether such discount offers will lead to a market blockade;
7. In addition to the aforementioned considerations, the concrete content of each case, the intention, purpose, market status of the subject of conduct, the structure of the relevant market, the characteristics of the product, and the impact of the discount offers on market competition are also considered in accordance with the “rule of reason.”

9. In addition, loyalty discounts refer to discounts offered to subscribers under the condition that the subscribers do not switch to different providers or large discounts given to subscribers with the potential to switch to other providers to prevent the loss of customers. Hence, such discounts are usually under the condition that subscribers do not switch to different providers and there is a form of switching cost to prevent them from deviating from the agreement. Loyalty discounts are basically viewed as a form of competition using discounts, and generally pro-competitive to benefit consumers. From an economic perspective, the main issue with loyalty discounts with respect to the restriction of competition is that they “lock out” customers, especially when the enterprise offering the discount has substantial market power. It is possible to lock out large numbers of customers with the strategy and foreclose the market from other competitors.

2. Case Example: Company A uses loyalty discounts to restrict subscribers from trading with its competitors

10. Background: Company A held the “Cargo Clearance Automation Network Service Promotion,” which includes two plans, Plan X and Plan Y. “Plan X” offers a 20% discount to those that use Company A’s cargo clearance automation network service during the promotion period (NT\$6.0 per thousand Chinese characters during peak hours and NT\$3.72 during off-peak hours); “Plan Y” offers a 40% discount to customers that commit themselves 100% to using Company A’s cargo clearance automation network service during the promotion period (NT\$4.5 per thousand Chinese characters during peak hours and NT\$2.79 during off-peak hours). If trading counterparts (users of the service) do not abide by their commitment, Company A has the right to terminate the discount and collect the difference from the original price for the amount of the discounts that had already been given to the customer.

11. Case analysis: The relevant market in this case is the “cargo clearance automation network service” market, the entire nation is the geographic market, and there are two market participants in the market, Company A and Company B with 91% and 9% of the market share based on revenue, respectively. Cargo clearance automation networks have the characteristics of the so-called “network effects” and “two-sided market.” Users are inclined to join the network with the most users under “network effects” (such networks have the most users they can communicate with). Under the influence of a two-sided market, cargo clearance automation network users are inclined to choose the network with the most users. Company A has a clear competitive advantage over Company B due to its first-mover advantages, user scale, and market share, as well as the network effects and characteristics of a two-sided market, and can utilize its dominant position to exclude competition. Company A has the ability to impact market function and exclude competition and is therefore a “monopolistic enterprise” as defined by the FTL.

12. Company A offered the “Cargo Clearance Automation Network Service Promotion” when Company B entered the market and began gaining customers of Company A using lower prices. There was also a discount offered by Company A in response to the competition, which is a normal process of market competition. However, besides the 20% discount offered under “Plan X,” Company A also offered a 40% discount under “Plan Y.” Under general market rules, customers will choose the plan that benefits them the most to reduce expenses, but Company A requires that customers use their services 100%, thereby showing a clear intention to restrict customers from switching to a different provider and hence locking out its existing users, thus creating the anticompetitive effect of foreclosure.

13. According to the statement given by Company A, 78 of its users chose “Plan X” and 1,215 users chose “Plan Y,” while the remaining 215 users did not participate in the “Cargo Clearance Automation Network Service Promotion.” Hence, the ratio of users that chose “Plan Y” exceeded 80% of Company A’s total number of users. The issue in this case is that if a user wishes to switch to the cargo clearance automation network service provided by Company B within 1 year of joining a plan offered by Company A, the user must pay the difference between the original price and the discounted price for the term of the services used as a penalty, thereby increasing the switching cost of users and reducing the incentive to choose services provided by Company B. Hence, “Plan Y” of Company A’s “Cargo Clearance Automation Network Service Promotion” clearly aims to restrict or exclude other competitors, and has prevented over 80% of Company A’s existing users from being able to switch to a different service provider, forming an artificial barrier to entry. The conduct was in violation of Subparagraph 1 of Article 10 of the FTA: “directly or indirectly prevent any other enterprises from competing by unfair means.”¹

¹ The case occurred before the amendment to the FTA on February 4, 2015, and the conduct was in violation of Subparagraph 1 of Article 10, which became Subparagraph 1 of Article 9 of the amended FTA after February 4, 2015.

3. Conclusion

14. The FTC has not set a specific priority for loyalty discounts, predatory pricing, or exclusive dealing cases, and handles cases when a complaint is received, but will carefully consider market structure, product or service characteristics, and the effects on competition in the market. This is to prevent enterprises from using complaints as a means to undermine the competition.

15. In the future, when handling loyalty discount cases, the FTC will carefully consider the following factors to determine whether loyalty discounts have the effect of restricting competition:

1. The severity and probability of competition restriction caused by loyalty discounts are both uncertain. Therefore, the application of the FTA must be analyzed on a case-by-case basis, by carefully examining different types of discounts and related market characteristics.
2. The basic consideration when determining whether loyalty discounts could potentially restrict competition is to examine whether prices increase in the long term. If prices increase, then the loyalty discounts may cause enterprises to gain market power and weaken market competition, further giving the enterprise the ability to raise prices. Whether or not the aforementioned situation has occurred can be determined by observing if the transparency of market prices has decreased, and observing the foreclosure of existing or potential competitors. The following market aspects can also be used to help the determination:
 1. Existing or potential competitors are not capable of offering the same loyalty discounts for consumers to switch away from.
 2. Existing competitors are forced to reduce production.
 3. Consumers do not have buying power to maintain or lower market prices to levels before loyalty discounts were offered.
 4. The long-term rise in market prices surpasses levels before loyalty discounts were offered, making existing competitors unable to increase their market share, and preventing potential competitors from entering or reentering the market.
 5. The benefits consumers gain from loyalty discounts are less than the losses they sustain from market prices increasing to levels higher than before loyalty discounts were offered.