

Raising the Bar: How Does China's *Tetra Pak* Decision Measure Up to the ECJ's Requirements for Loyalty Rebate Cases?

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In November 2016, about ten months prior to the European Court of Justice's (ECJ) *Intel* judgment, China's State Administration of Industry and Commerce (SAIC) fined the Swedish firm Tetra Pak \$97 million, after almost five years of investigation, for allegedly abusing its dominant position in the aseptic carton packaging equipment, materials, and service markets in China.¹ The SAIC published an unprecedentedly lengthy 47-page decision, in which it condemned three types of business practices allegedly adopted by Tetra Pak: tie-in sales, exclusive dealing, and loyalty rebates. Exclusive dealing and tying are explicitly specified in Articles 17(4) and (5) of China's Antimonopoly Law (AML), respectively, as prohibited behaviors of a dominant firm that constitute abuse. Thus, the SAIC had an easier job establishing these offenses after showing that Tetra Pak had dominance in the relevant markets, relative to finding illegal conduct in loyalty rebates, which are not specified in the AML.

Loyalty rebates are not explicitly addressed in the AML. The most applicable clause might be Article 17(2), which states that a dominant firm is prohibited from "selling commodities at a price below cost without proper reason" as well as the catch-all Article 17(7), identifying "other behaviors that are considered by the Antimonopoly Enforcement Agency as abuse of the dominant position in the market." With the uncertainty in the law, how the SAIC analyzed loyalty rebates has drawn significant attention from antitrust practitioners.

Loyalty rebates have been in the spotlight around the world in recent years. A number of U.S. cases have drawn much attention,² and there have been extensive discussions and intense debates in this area.³ The ECJ's recent *Intel* judgment resulted in additional heated discussion on this subject.⁴ While the *Intel* judgment tried to clarify a number of legal issues, arguably some ambiguities remain.⁵ However, the ECJ's *Intel* judgment raised the bar by making it more difficult

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¹ SAIC Competition Enforcement Public Notice No. 10 (2016) [hereinafter *Tetra Pak* Decision], http://www.saic.gov.cn/fldyfbzdzj/zjzfgg/201703/t20170309_232289.html. The SAIC is a ministry-level administrative agency that has a broad range of mandates in regulating the marketplace in China, including investigating non-merger and non-price related monopolization conducts. Such antitrust investigations are carried out by its Anti-monopoly and Anti-unfair Competition Enforcement Bureau. As is commonly done in antitrust writings relating to China, we use SAIC as the acronym for its antitrust enforcement bureau.

² Examples of cases that reached the circuit courts include: *Eisai Inc. v. Sanofi-Aventis U.S., LLC*, 821 F.3d 394 (3d Cir. 2016); *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254 (3d Cir. 2012); and *Allied Orthopedic Appliances v. Tyco Health Care Group LP*, 592 F.3d 991 (9th Cir. 2009). For discussions of these and other loyalty rebates cases in the United States, see, e.g., Jonathan M. Jacobson & Daniel P. Weick, *Countering Exclusion: The Complainant's Obligation*, 81 ANTITRUST L.J. 423 (2017); Derek W. Moore & Joshua D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 GEO. MASON L. REV. 1205 (2015); and Richard M. Steuer, *Musthavedness*, 81 ANTITRUST L.J. 447 (2017).

³ See, e.g., *Symposium: Conditional Pricing Practices*, 81 ANTITRUST L.J., 337 (2017).

⁴ Case C-413/14 P, *Intel Corp. v. Comm'n*, ECLI:EU:C:2017:632 (CJ Sept. 6, 2017) [hereinafter *Intel/ECJ* Judgment].

⁵ For a summary of the decision, see Mark Taylor & Jürgen Schindler, *Intel: Clarification or Contradiction?*, ANTITRUST SOURCE, Dec. 2017, https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/dec17_taylor_12_13f.authcheckdam.pdf.

to condemn loyalty rebates provided by a dominant firm in Europe, in essence requiring a rule of reason analysis of the rebate programs to evaluate their capacity to foreclose rivals and potential offsetting efficiency gains, as opposed to finding a per se violation of the EU competition law. In particular, the ECJ laid out the economic analyses that are required of the European Commission (EC) to prove liability⁶:

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[T]he Commission is not only required to analyse, first, the extent of the undertaking's dominant position on the relevant market and, secondly, the share of the market covered by the challenged practice, as well as the conditions and arrangements for granting the rebates in question, their duration and their amount; it is also required to assess the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market. . . . The analysis of the capacity to foreclose is also relevant in assessing whether a system of rebates which, in principle, falls within the scope of the prohibition laid down in Article 102 TFEU, may be objectively justified. It has to be determined whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer

In this article, we look back at the SAIC's *Tetra Pak* decision in light of the ECJ's *Intel* judgment. We start with a comparison between the two cases, the SAIC's *Tetra Pak* investigation and the EC's *Intel* investigation, the latter of which resulted in a decision issued by the EC in 2009⁷ and the ECJ judgment in 2017. We compare how dominance was shown and how loyalty rebates were approached in the two decisions. We then explore how the SAIC's *Tetra Pak* decision measures up to the ECJ's requirements for a finding of liability in loyalty rebates cases. In particular, we focus on a test that was at the heart of the *Intel* case and implied in the *Tetra Pak* case, as well as the analysis of the exclusionary effects in the two cases. By comparing these two decisions, we do not mean that the ECJ's decision should govern where the SAIC, an enforcement agency in a different jurisdiction, will be headed in the future, but rather, in the context of antitrust globalization, we explore what one would expect to see if a similar standard were followed in adjudicating such cases in China.⁸

Dominance

In its *Tetra Pak* decision, the SAIC first defined three relevant product markets based on demand and supply substitution analyses in accordance with China's Guidelines on the Delineation of Relevant Markets⁹: aseptic carton packaging equipment, technology services of aseptic carton packaging equipment, and aseptic carton packaging materials.

For each of these three relevant product markets, the SAIC determined that Tetra Pak was dominant based on the examination of four factors, as required by Article 18 of China's AML:¹⁰ (1) Tetra Pak's market share and the level of competition it faced in the relevant market; (2) Tetra Pak's abil-

⁶ *Intel* ECJ Judgment, *supra* note 4, ¶¶ 139–140.

⁷ COMP/C-3/37.990—*Intel*, Comm'n Decision (May 13, 2009).

⁸ For comparative legal studies on how loyalty rebates are treated in the United States and Europe, see, e.g., Daniel A. Crane, *Formalism and Functionalism in Antitrust Treatment of Loyalty Rebates: A Comparative Perspective*, 81 ANTITRUST L.J. 209 (2016).

⁹ Ministry of Commerce of the People's Republic of China, Guidelines on the Delineation of Relevant Markets Issued by the Antimonopoly Commission of the State Council (2009), <http://fdj.mofcom.gov.cn/article/j/200907/20090706384131.shtml>.

¹⁰ Article 18 of China's Antimonopoly Law also provides another factor for examination: the undertaking's financial capability and technological conditions. The SAIC decision touched upon Tetra Pak's technological advantage when discussing the other four factors.

ity to control the relevant market, including an examination of the contractual conditions Tetra Pak imposed on buyers; (3) buyers' reliance on Tetra Pak for the relevant products; and (4) barriers to entry.

Unlike Intel's position in the relevant market in EU's *Intel* case, where AMD was the only practical competitor, Tetra Pak faced competition from a number of (much) smaller rivals in each relevant market. Despite finding Tetra Pak's dominance in the three relevant markets, the SAIC acknowledged that Tetra Pak's shares in these markets, though above 50 percent, were decreasing in recent years. This latter observation on Tetra Pak's diminishing market shares does cast some doubt on the competitive impact of its alleged anticompetitive conduct, which we will discuss below.

Nature of Conduct: "Fidelity-Inducing" Rebates vs. Exclusivity Rebates

While the EC's allegations against Intel are based on exclusivity rebates,¹¹ i.e., rebates conditional on a customer purchasing all or almost all of its volume from Intel, the SAIC's allegations against Tetra Pak were based on "fidelity-inducing" rebates, i.e., loyalty rebates, which are less restrictive as they generally lack the explicit condition that a customer has to purchase all or almost all of its volume from the dominant firm.

Specifically, there are two types of "fidelity-inducing" rebates that the SAIC found problematic—"retroactive cumulative rebates" and "individualized targeted rebates." The former are described as setting cumulative rebates (i.e., rebates applied not only to the additional volume currently being purchased, but to the total volume of all past purchases within a certain period) of increasing size as the threshold increases.¹² The SAIC alleged that Tetra Pak offered this type of rebate not only on individual product lines but also on a combination of various product lines of packaging materials.¹³ The latter type of rebate is described as a rebate conditional on a customer purchasing a certain amount or a percentage of volume from Tetra Pak within a certain time period, with the targeted volume (specified in amount or percentage) set specifically for that individual customer.

Fidelity-inducing rebates are typically less restrictive than exclusivity rebates. However, if the dominant firm has good knowledge about its customers' demands, which is often the case, it could set up fidelity-inducing rebates with carefully constructed targets and incentives, so that they become in essence exclusivity rebates. Nonetheless, there are circumstances where the dominant seller may not want to achieve total exclusivity.¹⁴ From an economist's perspective, it makes sense to analyze fidelity-inducing rebates and exclusive rebates in the same manner.

Even for exclusivity rebates, the ECJ's *Intel* judgment seems to endorse a rule of reason approach if the alleged dominant firm submits evidence "that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects."¹⁵ In comparison, in the SAIC's *Tetra Pak* decision, the SAIC took the rule of reason approach analyzing the facts and effects of the exclusivity agreement Tetra Pak signed with a key raw packaging materi-

¹¹ *Intel* Commission Decision, *supra* note 7, ¶ 926.

¹² *Tetra Pak* Decision, *supra* note 1, at 34–35.

¹³ *Id.* at 35.

¹⁴ For example, the competitive harm from loyalty discounts may come from a softening of competition rather than exclusion. See Michael A. Salinger, *All-Units Discounts by A Dominant Producer Threatened by Partial Entry*, 81 ANTITRUST L.J. 2 (2017).

¹⁵ *Intel* ECJ Judgment, *supra* note 4, ¶¶ 138–140. See also Taylor & Schindler, *supra* note 5, at 4.

als provider that prohibited it from supplying such materials to third parties. Though this exclusivity agreement was with an upstream supplier instead of a downstream customer, it does show SAIC's willingness to conduct a rule of reason analysis in examining exclusivity agreements, which is to be commended in our opinion given the potential economic efficiencies inherent in such exclusivity provisions that should be taken into account.

As Efficient Competitor (AEC) Test

It appears that the AEC test plays a key role in both the EC's *Intel* decision and the SAIC's *Tetra Pak* decision. The purpose of the test is to see whether the dominant firm's specific conduct, for example, the use of loyalty rebates, is capable of excluding a competitor that is as efficient as the dominant firm. Although the EC did not consider an AEC test necessary,¹⁶ its discussion of the test in its *Intel* decision was extensive, accounting for almost a third of the total length of the decision.¹⁷ In the SAIC's *Tetra Pak* decision, the SAIC concluded that Tetra Pak's loyalty discount programs "caused foreclosure to its competitors in the short run, and resulted in their inability to compete with Tetra Pak at the same or similar costs."¹⁸ While the basic rationale and formula applied by both agencies seem largely consistent, the EC's *Intel* decision provides more details on the inputs to the calculations, whereas the SAIC's *Tetra Pak* decision does not. However, as explained in ECJ's *Intel* judgment, how exactly the AEC test should be carried out can be a subject of intense dispute between the private party and the agency, and may lead to different conclusions.¹⁹ In addition, whether or not the AEC test is an appropriate test to evaluate loyalty rebates in the first place is still a question under debate.²⁰

Although not explicitly labeled as an AEC test, the SAIC's *Tetra Pak* decision explains the basis for its finding of the anticompetitive effects of Tetra Pak's loyalty rebates as follows: First, it lays out the basic rationale and formula for the evaluation.²¹ Assuming that a customer's demand for packaging materials is Q , it could get a rebate of d (%) if it purchased all its volume from Tetra Pak, but could only get a discount of $d - \Delta d$ (%) if it purchased only part of its demand from Tetra Pak, specified as $Q - Q_2$.²² By choosing not to purchase all of its volume from Tetra Pak, the customer receives a smaller rebate on the portion of volume that stays with Tetra Pak, and the total amount of the loss equals $(Q - Q_2) * \Delta d$. In order for the customer to be willing to do so, this amount has to be "made up" on the volume that the customer purchases from the competitor, Q_2 . In other words, in order for a competitor to obtain part of this customer's volume, Q_2 , it is not enough for this competitor to offer a discount of d , but in addition it has to compensate the customer for the

¹⁶ *Intel* Commission Decision, *supra* note 7, ¶ 1155.

¹⁷ *Id.* ¶¶ 1002–1576.

¹⁸ *Tetra Pak* Decision, *supra* note 1, at 46.

¹⁹ *Intel* ECJ Judgment, *supra* note 4, ¶ 132.

²⁰ See, e.g., Sean Durkin, *The Competitive Effects of Loyalty Discounts in a Model of Competition Implied by the Discount Attribution Test*, 81 ANTITRUST L.J. 475 (2017) (arguing that loyalty discounts do not foreclose an equally efficient competitor unless they fail the discount attribution test); Chiara Fumagalli & Massimo Motta, *On the Use of Price-Cost Tests in Loyalty Discounts and Exclusive Dealing Arrangements: Which Implications from Economic Theory Should Be Adopted?*, 81 ANTITRUST L.J. 537 (2017) (finding a price-cost test not necessary, but informative); Steven C. Salop, *The Raising Rivals' Cost Foreclosure Paradigm, Conditional Pricing Practices, and the Flawed Incremental Price-Cost Test*, 81 ANTITRUST L.J. 371 (2017) (arguing that the incremental price-cost test is inappropriate and loyalty rebates should be analyzed under the raising rival's cost foreclosure paradigm).

²¹ *Tetra Pak* Decision, *supra* note 1, at 37–42.

²² Although the illustration provided by the SAIC is based on exclusivity rebates, similar arithmetic is applicable to "fidelity-inducing" rebates.

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additional loss in discount that the customer incurs by switching, which equals $(Q - Q_2) \cdot \Delta d / Q_2$. Therefore, the total discount offered by the competitor would be $d + (Q - Q_2) \cdot \Delta d / Q_2$.

Second, the SAIC decision explains that the SAIC conducted statistical analyses for the top 30 customers of Tetra Pak and found that a competitor would have to offer as high as twice the discount offered by Tetra Pak in order to obtain a “small volume of contestable demand.”²³ The decision further states that “the contestable demand is limited due to the specific market conditions in this case, thus requiring the competitor’s matching price to be very low.”²⁴ However, the decision does not provide any information on how low the competitor’s matching price has to be, and whether the level is below some cost measure. Judging from the decision, one may infer that the SAIC’s application of the AEC test may not be as complete as that of the EC in the 2009 *Intel* decision as explained below. The SAIC’s *Tetra Pak* decision concludes that the rebates “made it difficult for a competitor to participate in the competition, even possibly driving the competitor out of the competition, therefore inducing the customer to choose Tetra Pak, foreclosing competitors, and eliminating and restricting market competition.”²⁵

In contrast, in the EC’s 2009 *Intel* decision, in order to determine whether Intel’s exclusivity rebates were capable of causing anticompetitive foreclosure in the relevant market, the EC conducted an AEC test, positing a hypothetical firm that wants to enter the market and is at least as efficient as Intel. It tested whether there was a price this firm could charge to the Original Equipment Manufacturers (OEMs) that would allow it to stay in business and to compensate its OEM customers for losing rebates that they would have gotten from Intel.²⁶ Specifically, the cost benchmark against which the EC compares this firm’s price, to judge whether this firm would be able to stay in business, is average avoidable cost, for which the EC uses Intel’s Cost of Goods Sold as a proxy.²⁷ Intel contended that the EC wrongly carried out the AEC tests, for example, with respect to cost measures,²⁸ forgone rebates,²⁹ and contestable shares.³⁰ Intel put forth its own AEC tests.³¹ The ECJ ordered the General Court to retry the case, taking into consideration Intel’s line of argument regarding EC’s errors in regards to the AEC test.³²

Comparing the AEC tests implied in the SAIC’s *Tetra Pak* decision and explicitly conducted in the EC’s *Intel* decision, the EC decision provides more details, including discussions of the cost measures that are not present in the SAIC decision. Perhaps more importantly, the EC decision describes the counter arguments raised by the alleged offender and provides detailed responses to such arguments, which offers a balanced and transparent disposition.

²³ *Tetra Pak* Decision, *supra* note 1, at 42.

²⁴ *Id.* at 45.

²⁵ *Id.*

²⁶ *Intel* Comm’n Decision, *supra* note 7, ¶ 1003.

²⁷ *Id.* ¶¶ 1037, 1043.

²⁸ *Id.* ¶¶ 1045–1050.

²⁹ *Id.* ¶¶ 1160–1164, 1195–1197.

³⁰ *Id.* ¶¶ 1215–1216, 1222, 1229, 1231–1232, 1239, 1241, 1335, 1345, 1352–1353, 1358, 1479–1480.

³¹ *Id.* ¶¶ 1038, 1040.

³² *Intel* ECJ Judgment, *supra* note 4, ¶ 138–147.

Exclusionary Effect of Loyalty Rebates

The ECJ considers the analysis of the capability of restricting competition to be relevant in assessing whether loyalty rebates should be prohibited under the EU law.³³ One possible interpretation of this judgment is that “capability” of restricting competition, as opposed to actual foreclosure effect, arguably sets a low threshold that would only require a certain level of plausibility that the conduct could restrict competition.³⁴ Based on this interpretation of the low threshold, the SAIC’s *Tetra Pak* decision seems to have provided ample evidence to support such capacity to foreclose. However, focusing too much on theoretical capability runs the risk of conflicting with empirical observations that may indicate a lack of actual foreclosure effects.

As explained above, it appears from the SAIC’s *Tetra Pak* decision that the SAIC presumed a finding of foreclosure effects, after concluding that the rebates offered by Tetra Pak required the competitors to offer a lower, and sometimes much lower, price. The conclusion seems inconsistent with other facts that suggest a lack of actual foreclosure effects. For example, in the earlier part of its decision, the SAIC listed ten other competitors in China’s aseptic carton packaging materials market, and stated that Tetra Pak’s share had been decreasing over the period of 2009–2013, albeit it was above 60 percent in all years.³⁵ There is also no mention of a single instance of a competitor’s exit from the marketplace due to the loyalty rebates, or tying and exclusive dealing practices alleged in the SAIC decision. Indeed, the market facts seem to suggest that Tetra Pak’s rebates could have been a procompetitive response to increasing competition.

It is possible that the foreclosure effects work through raising rivals’ costs by limiting rivals’ scale of operation, but not by eliminating the rivals from the market. In the *McWane* case, the Federal Trade Commission issued a decision finding that McWane unlawfully monopolized the domestic fittings market through its Full Support Program, which foreclosed potential entrants from accessing distributors.³⁶ The FTC decision was upheld by the Eleventh Circuit.³⁷ In that case, McWane’s rival and a potential entrant, Star Pipe Products, actually entered the market. But McWane’s exclusive dealing policy was considered to have raised Star Pipe Products’ distribution costs and prevented it from achieving the minimum efficient scale.³⁸ Though the SAIC’s *Tetra Pak* decision mentions the loyalty discounts’ effects on competitors’ capacity utilization and the ability to expand,³⁹ there is certainly room for better development of this argument, perhaps with quantitative evidence and analysis. After all, procompetitive price responses by a dominant firm will also have the effect of limiting competitors’ capacity utilization.

Additionally, in contrast to the EC’s 2009 Intel decision, the *Tetra Pak* decision does not offer detailed customer-specific analysis of the dominant firm’s attempt to delay or stop the customer from switching to a competitor using its loyalty discounts, which would have been more consis-

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³³ Taylor & Schindler, *supra* note 5, at 4.

³⁴ *Id.* at 5.

³⁵ *Tetra Pak* Decision, *supra* note 1, at 16–17.

³⁶ *McWane, Inc.*, FTC Docket No. 9351 (2014), <https://www.ftc.gov/enforcement/cases-proceedings/101-0080b/mcwan-inc-star-pipe-products-ltd-matter>.

³⁷ *McWane, Inc. v. FTC*, 783 F.3d 814 (11th Cir. 2015).

³⁸ *But see* Commissioner Joshua D. Wright’s dissenting statement for a different opinion, https://www.ftc.gov/system/files/documents/public_statements/202211/140206mcwanestatement.pdf.

³⁹ *Tetra Pak* Decision, *supra* note 1, at 45.

tent with a rule of reason approach supported by the ECJ for proving that the conduct is “capable of restricting competition.”⁴⁰

Conclusion

Loyalty rebates have been in the antitrust headlines worldwide in recent years, and such cases continue to emerge.⁴¹ Both antitrust enforcement agencies and the courts in different jurisdictions need to tackle these difficult issues. With no clear consensus on the assessment criterion in sight, it is desirable for the agencies and courts to take a prudent approach.

The ECJ's *Intel* decision provides some clarification and support for a rule of reason approach that requires clear and detailed showing of factual evidence and economic analysis. Against this backdrop and in retrospect, the SAIC's *Tetra Pak* decision was generally consistent with the principles advocated in the ECJ's *Intel* decision, but on the other hand there is clearly room for improvement in providing more details of its analysis and in showing actual exclusionary effects. ●

⁴⁰ *Intel* ECJ Judgment, *supra* note 4, ¶ 149.

⁴¹ See, e.g., Foo Yun Chee, *Exclusive—Chipmaker GlobalFoundries Asks EU to Investigate Bigger Rival TSMC: Source*, REUTERS, Sept. 21, 2017, <https://in.reuters.com/article/eu-tsmc-globalfoundries-antitrust/exclusive-chipmaker-globalfoundries-asks-eu-to-investigate-bigger-rival-tsmc-source-idINKCN1BW2HQ>; Carolyn Y. Johnson, *Pfizer Sues Johnson & Johnson, Alleging Anticompetitive Practices to Maintain a Drug Monopoly*, WASH. POST, Sept. 20, 2017, https://www.washingtonpost.com/news/wonk/wp/2017/09/20/pfizer-sues-johnson-johnson-alleging-anticompetitive-practices-to-maintain-a-drug-monopoly/?utm_term=.4cc95810f6ad.