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**ROUNDTABLE ON FIDELITY REBATES**

-- Note by Korea --

15 – 17 June

*This document reproduces a written contribution from Korea 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](http://www.oecd.org/daf/competition/fidelity-rebates.htm)*

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## **1. Introduction**

1. In general, competition laws evaluate the legality of a certain act based on whether the act concerned has an anti-competitive effect or not. The MRFTA is no exception to this. However, in addition to the anti-competitive effect, the MRFTA also considers whether the act undermines fair trade. That is, the MRFTA regulates “unfair trade practice” as a separate type of behavior whose legality is determined by assessing whether it undermines fair trade or not.

2. Loyalty rebates or discounts refer to a behavior where a company demands its buyers various forms of loyalty and in return, the company provides price discounts. Under Korea’s MRFTA, loyalty rebates could be counted as either exclusive dealing as an abuse of market dominance or unfair attraction of customer as an unfair trade practice.

3. The KFTC has actively enforced its law against exclusive behaviors or unfair attraction of customers relating to loyalty discounts in various areas such as computer, IT, pharmaceutical, liquor, etc. This paper aims to explain criteria for judging the illegality of exclusive dealing and unfair attraction of customers as well as recent case examples where the provisions concerned were applied.

## **2. Exclusive Dealing, as An Abuse of Market Dominance**

4. Loyalty discounts or fidelity rebates are increasingly used as a pricing strategy by dominant enterprisers, where they provide benefits such as rebates or price discounts to customers for making large-scale purchases.

5. Although not all price discounts are deemed illegal, in particular cases where a dominant enterpriser uses the price discount with the intent to foreclose competitors, thereby protecting its own interests as well as strengthening and abusing its market dominance, the illegality of the conduct can be established.

## **3. Characteristics of Pricing Policy that Employs Loyalty Discounts**

6. Loyalty discounts are seemingly similar to volume discount. With regard to this, the KFTC presents three characteristics of the rebate structure of loyalty discounts as follows.

7. First of all, when we take a look at pricing policies that employ loyalty discounts, their rebate payment structures are designed to provide rebates differently from trade partner to partner depending on from whom and how much they purchase. If rebate payment reflects economic efficiency, then it should be paid in accordance with objective criteria such as purchase amount, irrespective of who the purchaser is. However, loyalty rebates’ payment structure is different from purchaser to purchaser. That is, individualized rebate payment criteria are applied. A dominant enterpriser sets individualized rebate payment criteria for each purchaser at such a level that makes the purchaser difficult to switch its demand, creating a maximum loyalty enhancing effect.

8. Secondly, pricing policies that employ loyalty discounts provide rebates or discounts retroactively. Under this retroactive strategy, the rebates or discounts are not provided at the time of purchase but the goods or services are just sold at their market prices, but when a certain period of time is passed, the seller checks whether the purchaser satisfies the rebate requirements and provides rebates on all units purchased. What characterizes this strategy is that it induces loyalty enhancing effect more than simply granting discounts only on the purchases made in excess of the amount required to achieve the threshold (incremental rebate).

9. Thirdly, under the structure of price policies that employ loyalty discounts, when the purchase of the company's products increases relatively, the rebate payment rate increases progressively. Under this structure, purchaser has the incentive to increase its purchase even after the required purchase threshold is met so the rebates are granted. It maximizes the opportunity cost of switching to an alternative supplier, thereby making it hard for purchasers to initiate transaction with other suppliers. That is, under the progressive rebate structure, when a purchaser reduces its sales with competitors and increases its sales with the dominant firm, more rebates will be granted, so their incentive to have business with competitors gets more restrained.

#### **4. Requirements for Exclusive Dealing to Be Illegal**

10. Korea's MRFTA does not specifically define and regulate loyalty discounts and rebates. However, its provisions on abuse of market dominance, namely on the prohibition on exclusive dealing, can be applied to loyalty discounts when these discounts constitute a dominant enterpriser's anti-competitive discounting behavior.

11. For the illegality of an exclusive dealing as an abuse of market dominance to be established, there are three requirements: the enterpriser should be a market-dominating firm; the firm should condition its business with a trade partner on the trade partner's not having business with its competitors; and it should be unfair.

##### **4.1 *Judging Whether the Enterpriser Concerned Is Dominant***

12. Market-dominating enterpriser means an enterpriser which is in a position capable of setting, maintaining and changing the price, quality, output and trade conditions of product or service unilaterally or collectively with other enterprisers as a supplier or a buyer in a certain business area. To assess whether an enterpriser is a market-dominating one, the KFTC comprehensively takes into account market share, existence and level of entry barrier, relative size of its competitors, etc.

##### **4.2 *Judging Whether It Is Exclusive***

13. Exclusive dealing, or a trading behavior conditioned on not having transaction with competitors, has been construed in a wide manner by the KFTC, reflecting the purpose of the MRFTA - promoting competition in the oligopolistic or monopolistic market.

14. In other words, when it is recognized that the condition of not having business with competitors – even when this condition is not unilaterally set by the dominant firm but by an agreement with the trading partner – practically has the binding power, such a case is included in the broad definition of exclusive dealing. Also, not just a complete ban on trading with other enterprisers but also a partial ban on trading is also counted as an exclusive dealing.

15. The reasoning behind this broad definition of exclusive dealing is that as the intent of the prohibition on exclusive dealing is to prevent market-dominating enterprisers from abusing their dominance to foreclose competitors and maintain and strengthen their dominance, if the prohibition concerned only includes exclusive dealings that are conditioned on total ban of trading with competing enterpriser, the purpose of this prohibition may not be achieved as some of the abuses of market dominance will be able to evade the law.

### **4.3 *Judging Whether It Is Unfair***

16. The unfairness of an exclusive dealing should be assessed in line with the purpose of the Act: promoting competition in the marketplace. Therefore, the unfairness can be established if a dominant market player has the intent to artificially influence market order by limiting free competition in the market with a purpose of maintaining and strengthening its market dominance and there is an objective reason to believe that the exclusive dealing concerned has the potential to have anti-competitive effect. Therefore, assessing the unfairness of an exclusive dealing as an abuse of market dominance should take various factors into consideration: the purpose and conduct of the dealing, market share of the dominant firm, how much competitors' entry into the market or market expansion opportunity was foreclosed, whether the act has raised costs, duration of the transaction, whether the act has changed the price and output in the relevant market, whether there exist similar products and adjacent market, whether innovation and diversity are undermined, etc.

17. However, as far as proving the intent or purpose to limit competition is concerned, the Supreme Court of Korea ruled that exclusive dealing is an act that conditions the transaction on not trading with competitors, so the act has in its nature the intent to limit competition. Therefore the Supreme Court relieves the level of proving the anti-competitive intent or purpose when applying law to exclusive dealing.

## **5. Case Examples**

### **5.1 *Qualcomm's Provision of Conditional Rebates***

#### **5.1.1 *Case Overview***

18. Starting from July, 2000, Qualcomm provided rebates to handset manufacturers on condition that they purchase most of the modem chips and RF chips they need from Qualcomm. Once the quarterly purchase ratio has reached a certain threshold (75~95%), the company received more rebates from Qualcomm as they purchase Qualcomm's products more in relative or absolute terms.

19. With regard to Qualcomm's conditional rebates, the KFTC concluded that Qualcomm prevented handset makers from purchasing modem chips and RF chips from competitors, thereby keeping the competitors from entering the market. Also, Qualcomm's individualized rebate payment scheme, retroactive and progressive rebates, and uncertainty of price mechanism have made it difficult for handset manufacturers to switch their demands. Therefore, Qualcomm's conduct constitutes an exclusive dealing as an abuse of market dominance.

#### **5.1.2 *Determining The Illegality of The Conduct***

- Whether Qualcomm is a market-dominating enterpriser

20. As of 2006, Qualcomm had the market share of 87% in the global CDMA2000 modem chip market and 98% in the Korean CDMA2000 modem chip market. As Qualcomm's market share was well above the 50% threshold whether the relevant market is global or Korea, its market dominance could be presumed.

- Whether The Deal Was Exclusive

21. In this case, the KFTC deemed Qualcomm's conduct as an exclusive dealing based on the following reasons.

22. Firstly, Qualcomm provided rebates on condition that the buyer purchases a certain ratio of its modem chip demand from Qualcomm. It is basically the same as conditioning to maintain its purchase ratio of modem chips from Qualcomm's competitors to the total demand below a certain level. Therefore, the KFTC deemed that such a trading condition is like setting a condition not to have business with competitors to a certain level.

23. Secondly, the conditions Qualcomm proposed to handset makers are structured like a loyalty discount arrangement. The rebate at issue was provided retroactively: handset makers first paid market prices for modem chips, and when the rebate conditions – more than a certain ratio of Qualcomm's products to the total demand shall be purchased – were met, the rebates were granted retroactively. Also, the rebate level progressively increased as the purchase ratio of Qualcomm's products increased. This rebate structure induces handset makers to purchase more than the level set as the minimum to receive rebates. Also, even after reaching the minimum purchase threshold, handset makers were likely to continue increasing their purchases, so the loyalty enhancing effect was created and it became more and more difficult for the purchasers to switch its demand to an alternative supplier.

24. Thirdly, the conditions proposed by Qualcomm to handset makers practically constitute a monetary sanction. The modem chip prices that were set through the negotiation between Qualcomm and handset makers had the precondition that the rebates will be provided later on. Therefore, this means that if handset makers fail to meet a certain purchase ratio, it could not receive rebates, which could basically serve as a monetary sanction. Also, the KFTC confirmed that during negotiation, both Qualcomm and handset makers considered such a condition as a monetary sanction.

- Whether It Was Unfair

#### 5.1.3 *Anti-competitive Intent · Purpose*

25. Basically, in this case, a dominant enterpriser reached a conditional rebate agreement with trade partners. The KFTC found that the imposition of the conditions has not produced much efficiency enhancing effect. And the KFTC deemed that the conduct of restricting handset makers from purchasing competitors' modem chips itself is sufficient to presume an anti-competitive intent.

26. Furthermore, the rebate arrangement was made around the time when Qualcomm had concerns over its decreasing market share in the Korean market. Also, the handset makers simply requested for a rebate, but it was Qualcomm that added exclusivity condition to it. Qualcomm itself was aware that the main motive of the rebate was to keep competitors in check, and there are no other precedent similar to Qualcomm's conditional rebate case found in the telecommunications industry. Taking all these facts into consideration, the KFTC concluded that Qualcomm's anti-competitive intent · purpose could be established.

#### 5.1.4 *Anti-competitive Effect*

27. First of all, the payment of rebates in this case lasted for a long period of time (9 years), sufficiently long enough to serve as an entry barrier. The period also overlaps with the period during which Qualcomm imposed discriminatory royalty. Therefore, the KFTC concluded that Qualcomm's provision of conditional rebates served as an entry barrier in the relevant market.

28. Secondly, Qualcomm designed the rebate payment structure based on the ratio of its products purchased to the total demand, so that its competitors will not be able to respond to it by adjusting the level of price discount. Coupled with discriminatory royalties, this loyalty rebates generated bigger anti-

competitive effect. Also, Qualcomm's modem chip rebates were about all types of modem chips products Qualcomm offers, so in order to have a discount competition with Qualcomm, competitors which only produce low-end products were pressured to consider the rebates given to high-end products by Qualcomm and significantly cut the price of their low-end products, which means it was practically impossible for them to respond to Qualcomm's rebate scheme.

29. Thirdly, Qualcomm imposed discriminatory royalties in favor of its buyers which purchased more than 80% of their modem chip demand from Qualcomm in the CDMA2000 modem chip market. In addition Qualcomm pursued exclusive dealing to make them buy its modem chips. Qualcomm made it practically impossible for its competitors to secure alternative trading partner large enough to create economy of scale in the Korean CDMA2000 modem chip market.

30. Fourth, up until 2004, Qualcomm maintained the market share of 98-99% in the Korean CDMA2000 modem chip market. So, it is sufficient to say that during the period of rebate scheme, Qualcomm successfully foreclosed its competitors in the Korean CDMA2000 modem chip market.

## **5.2 Intel's Exclusive Dealing Case**

### *5.2.1 Case Overview*

31. Intel provided various kinds of rebates to Korean PC manufacturers from July 2002 to June 2005 on condition that: a) they stop purchasing CPUs from its competitor, Advanced Micro Devices (hereinafter "AMD") or they maintain the purchase ratio of Intel's CPU products at a certain level, and b) when it comes to PCs that are sold on specific retail channels (home shopping) they do not mount AMD's CPUs on these PCs or they maintain the purchase ratio of Intel's CPU products at a certain level. In Nov. 2008, the KFTC imposed remedies and penalty surcharges against Intel for such conducts, considering them as an abuse of market dominance, namely exclusive dealing.

### *5.2.2 Determining The Illegality of The Conduct*

- Whether Intel is a market-dominating enterpriser

32. As Intel's market share in the Korean CPU market is above 95% on average, the KFTC presumed under Article 4 (1) of the MRFTA that Intel is a market-dominating enterpriser. In addition, the KFTC took into account other factors such as the fact that the entry barrier of the CPU market is very high and Intel's only competitor AMD falls way behind Intel in terms of market share, production capabilities and financial power.

- B. Whether The Deal Was Exclusive

33. Intel divided PC manufacturers into A, B, and C categories based on their purchase amount and status in the market, and set prices differently for each category. Intel also agreed to provide rebates to PC manufacturers on condition that they don't use AMD's CPUs at all on the PCs for home shopping, and maintain Intel's market segment shares at around 70 to 100%.

34. Intel argued that as the condition of not having business with AMD was not stated as a direct condition for providing rebates to PC makers, it is not an exclusive dealing. However, the KFTC and the court responded that not only a complete ban on business but also the limitation of free trade by setting a certain threshold above which the companies are limited to have a business constitute an exclusive dealing.

35. That is, Intel's conditioning the provision of rebates on maintaining the market segment share at a certain level practically made PC makers purchase all CPU units they need from Intel or buy AMD's products by less than a certain threshold. So it constitutes an exclusive dealing.

- Whether It Was Unfair

### 5.2.3 *Anti-competitive Intent · Purpose*

36. The KFTC and the court concluded that Intel, which had enjoyed dominant status in the Korean CPU market, was threatened by AMD's introduction of CPUs and expansion in the market, so it provided rebates on exclusive condition with a goal to maintain its market dominance and to foreclose AMD based on the following grounds.

- The violation of law took place when AMD was about to advance into the Korean market taking advantage of PC manufacturers' introduction of low-end models for home shopping channels.
- The PC makers, the parties to the exclusive dealing agreement of this case, were first and second largest PC manufacturers in Korea. If the two increase the ratio of AMD's CPU during the course of their price competition, Intel expected that this will bring Intel's market share down.

### 5.2.4 *Anti-competitive Effect*

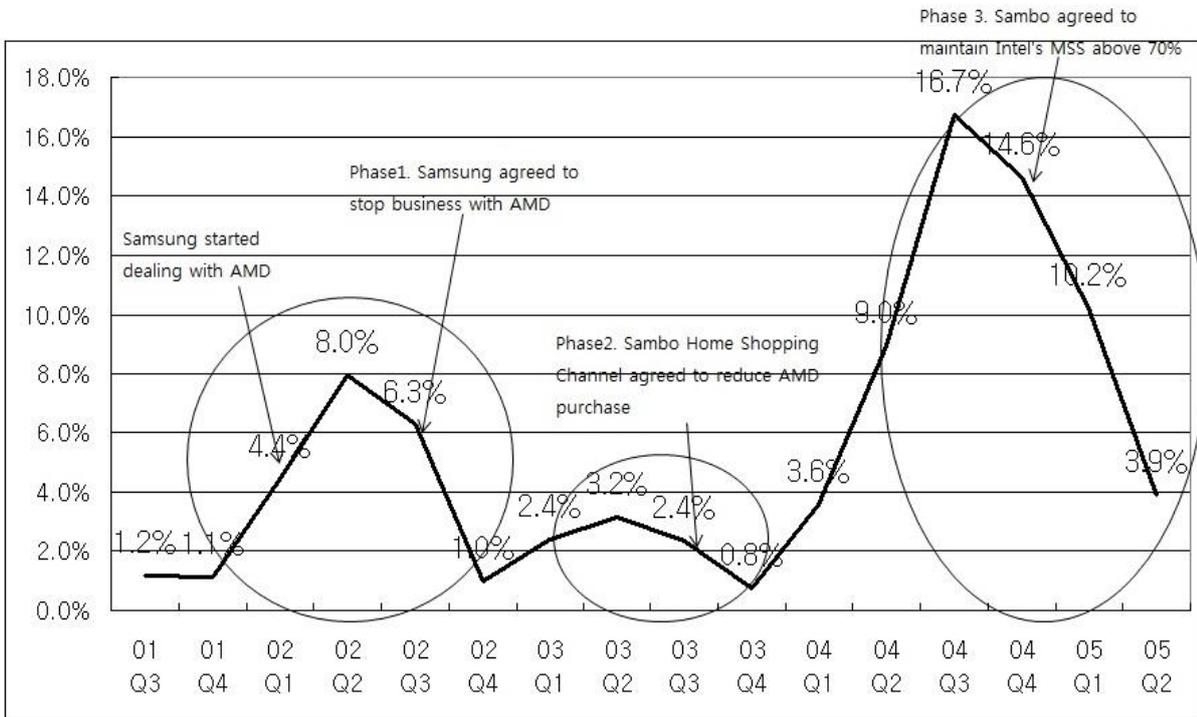
37. When determining the case's anti-competitive effect, the KFTC and the court took into account i) trade behaviors, ii) how much competitor's market entry or market expansion opportunity was foreclosed, and iii) consumer welfare.

38. Firstly, the rebate conditions concerned stipulate that PC makes shall maintain the ratio of Intel's products to total CPU demand above a certain threshold. Furthermore, the conditions demand that Intel shall receive information about the PC maker's transactions with competitors for the purpose of making sure before granting rebates. So, it seems that Intel practically controlled PC manufacturers not to have business with its competitors.

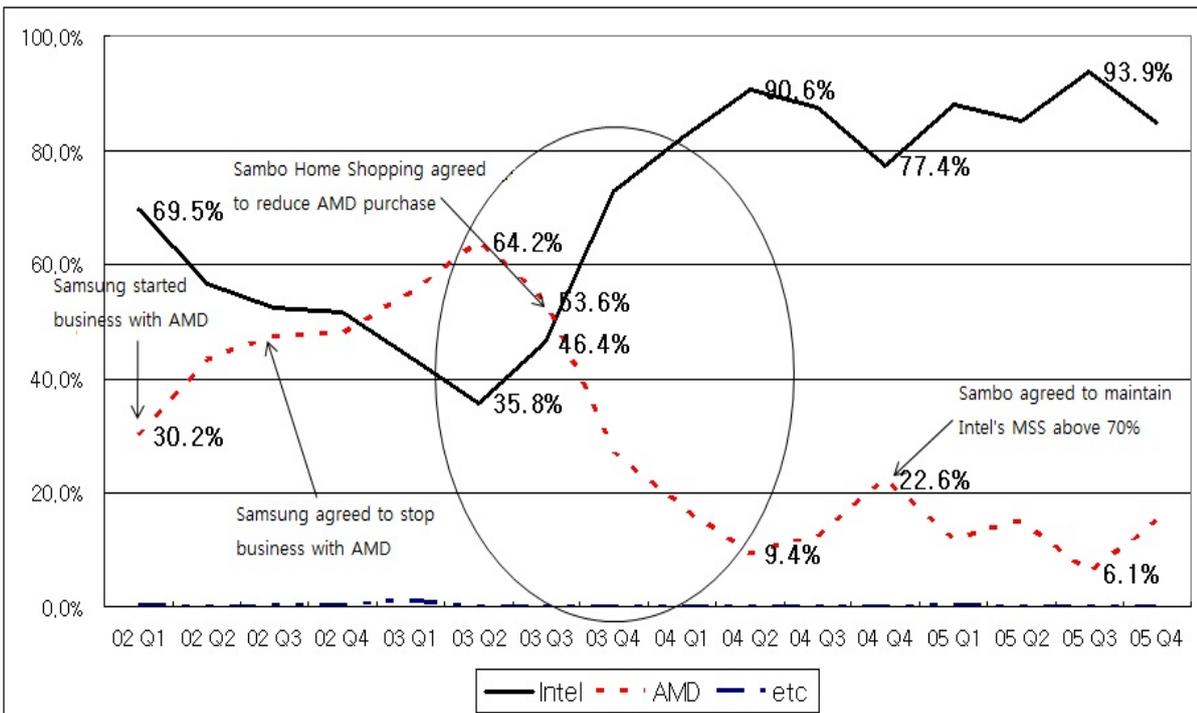
39. Secondly, when it comes to actual market shares, given the fact that the competitor's market share has significantly dropped due to Intel's exclusive dealing, it was deemed that there was an effective foreclosure effect. That is, in the relevant market, AMD's market share went up to as high as 8% in the second quarter of 2002, but starting from the third quarter, when Intel's conduct at issue started, AMD saw its market share fall to as low as 1-2%.

40. Thirdly, in terms of consumer welfare, Intel's conduct caused Korean PC makers not to make PCs with AMD's CPUs or to put a limit on the production thereof. This has reduced the product diversity of the market and limited options available for consumers. By making more Intel's CPUs bought by PC makers, the price for PCs have remained high, etc. which has undermined consumer welfare.

**AMD's market share in the Korean market**



**MSS of CPUs mounted on PCs for home shopping**



## 6. Unfairly inducing customers of competitors, as an unfair trade practice

- When there exists a loyalty discount behavior, even when it does not constitute a dominant enterpriser's exclusive dealing, it can also be caught by Article 23 of the MRFTA as an unfair inducement of customers.
- In order to maximize consumer satisfaction, purchasing quality products for low prices based on accurate information should be possible. To that end, the price and quality of products or services should be the means of competition. Inducing customers of competitors through providing unfair benefits, using deception, interrupting trade, etc. are banned as they are an unfair means of competition, so they undermine desirable competition order and hinder consumers from choosing products or services with good quality and cheap price.

### 6.1 *Conducts That Constitute An Unfair Inducement of Customers*

41. Basically, conducts that provide or propose to provide benefits to competitors' customers with a goal to take them away from the competitors are subject to the provision on "unfair inducement of customers." Here, not just customers which have had or are currently having business with competitors but also the ones that have the potential to have a trading relationship with competitors in the future are also included as competitors' customer.

42. The methods of providing or proposing to provide benefits are not limited, and include advertisement and indications. Benefits include all forms of financial benefits including passive provision of benefits: rebates, price discounts, setting and changing trade terms to be favorable to customers, monetary support for promotion or promotional materials, throw ins more than what is necessary on condition that customers switch their demand from competitors, reducing fees or costs that are supposed to be imposed, offer of collateral or exemptions of accessorial charges.

### 6.2 *Requirements for the Inducement of Customers to Be Illegal*

43. For an inducement of customers through provision of unfair benefits to be established, i) the conduct should provide or propose to provide benefits that are deemed unfair or excessive compared to normal business practices, and ii) should have the potential to undermine fair trade.

44. Firstly, normal business practices are determined comparing with the common business practices of the business concerned as a matter of principle. But depending on cases, normal business practices could mean a practice in line with desirable competition order, so it does not have to be identical with real-life trade practice. Furthermore, Judgment on whether the benefit is unfair or not should be based on relevant legal prohibitions or normal business practice, whether it is excessive or not should be determined by whether it exceeds the level deemed normal compared to common business practices.

45. The methods of providing or proposing to provide benefit are not limited, and include active provision of benefits such as setting or changing trade terms or providing promotional materials as well as passive provision of benefits such as reduction of payable fees or costs.

46. Secondly, whether the provision of unfair benefit has the possibility of inducing customers of competitors to deal with the provider of such benefits concerned or not is determined by whether it is possible for the conduct to have an influence over the customers' decision making or not. Here, customers of competitors mean not just customers who are in business relation with competitors but also potential customers who can in the future have business with competitors. Also, it is not necessarily the case that the enterpriser that provides or proposes to provide benefits should have an actual business going on with customers concerned. As long as there

is a possibility that the enterpriser's conduct is likely to have a significant impact on the customers' decision making, the unfair inducement of customer can be established.

47. Thirdly, the effect of undermining fair trade is a term broader than anti-competitive effect. In the KFTC's Review Guidelines on Unfair Trade Practices, the effect of undermining fair trade includes both "anti-competitiveness and unfairness" Here, unfairness means that the means of competition or the contents of transaction is not fair. Unfairness of the means of competition refers to that the means of competition, other than the quality or price of the product or service, was so undesirable that it has undermined or is likely to undermine fair competition in the market. Unfairness of the contents of transaction means that the foundation of fair trade is undermined or is likely to be undermined as trade partners were kept from making a free decision or were forced to accept disadvantages.

48. Nevertheless, even when the conduct concerned is recognized to have used unfair means of competition, if the conduct's effect of enhancing efficiency or consumer welfare is much above its effect of undermining fair trade, or it is recognized that there is a reasonable ground for such a conduct, the conduct may not be deemed illegal.

### **6.3 Case Example: KT&G's unfair Inducement of Customers**

#### *6.3.1 Case overview*

49. KT&G, which is a dominant player in the Korean cigarette market, made convenience stores and their headquarters fill more than 75% of their shelves with KT&G's products. Moreover, KT&G provided rebates to large-scale discount stores based on the ratio of KT&G products they put on display, and gave small retailers rewards on condition that they reduce the ratio of competitors' products they carry. The KFTC deemed that such conducts constitute an unfair inducement of customers, among the types of unfair trade practice.

#### *6.3.2 Judging Illegality*

- Whether it proposed to provide benefits that are unfair or excessive compared to normal trade practices

50. KT&G provided rewards on condition that cigarette retailers reduce the ratio of competitors' products they carry, and the KFTC deemed this as an unfair inducement of customers among unfair trade practices and sanctioned it. When deciding what and how much products to carry, it is natural that such a decision reflects consumer's preference. However, KT&G provided benefits to distort market demand and build artificial entry barriers. Therefore, the KFTC concluded that it was unfair compared to normal business practices.

51. Furthermore, the KT&G's rebates were more than a volume discount, in which the level of discount to be provided was linked to the sales amount. KT&G's discounts intend to reduce the amount of competitors' product out in the market.

- Whether The Conduct Had The Potential to Undermine Fair Trade

52. Firstly, when looking closely at the behaviors concerned such as deciding the ratio of products on display or deciding the scope of discounts depending on the sales ratio of competitor's products, the inducement of customers concerned had a goal and intent to limit competitors' sales or to block the market entry of competitors.

53. In particular, the limit on the ratio of products put on display was deemed to have distorted consumer preference and trade as it could not reflect the actual reality such as consumer preference appeared through market shares. That is, as for convenient stores' headquarters, it would have been natural if they could offer competitors' cigarettes and displayed products based on market shares (some 48%). However, the headquarters

had to put KT&G's products on display more than KT&G's market share (52%) due to KT&G's product display limitation.

54. Thirdly, KT&G's conditional provision of rebates constitute a provision of benefits that are banned by Tobacco Business Act, and given that such a provision has a high likelihood of inducing customers of competitors to switch their demand to KT&G's products, the KFTC deemed that the conduct has the potential to undermine fair trade.

## **7. Conclusion**

55. The KFTC's regulation considers loyalty rebates as two behaviors: exclusive dealing as an abuse of market dominance; unfair inducement of customers as an unfair trade practice.

56. First of all, when it comes to an exclusive dealing as an abuse of market dominance, as the Qualcomm, Intel and KT&G cases show, what characterizes loyalty rebates or discounts is that its rebate payment structure is set differently from buyer to buyer based on the buyer's likelihood to switch its demand from competitors. The condition for rebates is applied retroactively, which creates maximum loyalty enhancing effect. In addition, when a buyer purchases more products, the rebate rate for the buyer increases progressively. It was commonly found that through loyalty discounts, dominant enterprisers prevent customers from initiating business with or switching their demand to competitors.

57. Also, loyalty discounts are not necessarily limited to the imposition of exclusivity, which means law enforcement needs to be more active. This is because even when a dominant enterpriser does not directly foreclose its competitors, it can effectively foreclose their market entry or expansion by simply restricting or reducing the incentive for consumers to deal with them.

58. This effect was clearly shown in the Intel case. When the sales of AMD's CPU, which is fit for low-end PCs for home shopping, was increased to as high as 8%, what Intel asked Korean PC makers in return for rebates was not stopping the purchase of AMD's products. Rather, Intel asked them to maintain their purchase ratio of Intel's CPUs to the total demand at 70% to 100%. This has practically had the effect of limiting buyers' purchase of AMD's CPUs. For example, as a consequence, the market share of AMD's CPU went down to 1-2%.

59. As for enforcing law against an unfair inducement of customers as an unfair trade practice, we need to have a perspective different from that of exclusive dealing. Enforcement against exclusive dealing focuses on the conduct's anti-competitive effect. However, enforcement against an unfair inducement of customers focuses on whether the conduct undermines fair trade itself. In other words, when rebates provided by a dominant enterpriser foreclose the enterpriser's competitors or raise market entry barrier, such a conduct is subject to prohibition on exclusive dealing, but when a provision of rebates undermines reasonable decision making of a trade partner, such a conduct is subject to prohibition on unfair inducement of customers.

60. This perspective can explain much about the countermeasures taken by the KFTC. KT&G's provision of rebates was an anti-competitive behavior that undermines competition in the market. At the same time, the conduct also limited KT&G's trade partners from pursuing fair trade itself. That is, KT&G's conduct was deemed to have the potential to undermine fair trade: it had the intent of making its trade partners exclusively deal with itself or reducing their trade with KT&G's competitors; the conduct constitutes the provision of unfair benefits which is banned by relevant law (Tobacco Business Act); and the provision of rebates was highly likely to induce customers of competitors to buy KT&G's products.