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Competition Issues in Aftermarkets - Note from Chinese Taipei

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More documents related to this discussion can be found at

www.oecd.org/daf/competition/aftermarkets-competition-issues.htm

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This report will explain enforcement criteria and considerations adopted by the Fair Trade Commission (hereinafter referred to as the "FTC") of Chinese Taipei in aftermarket cases.

1. Enforcement experience

1. The needs of secondary products arise when primary products, especially in durable goods markets rely on complementary products or services to continue to be usable, or rely on new services to enhance the product's functionality.

2. The commercial considerations for enterprises in aftermarkets are mainly to maintain the market share and importance of the primary product, as well as monitor the quality of products in the aftermarkets. Yet, when an enterprise extends their market power to the aftermarket, it may prevent rivals from entering the aftermarket, resulting in fewer options for consumers and giving enterprises the opportunity to raise secondary products' prices. This may reduce other enterprises' intention to engage in innovation.

3. With the influence of leverage theory, tie-ins that improperly extend the market power in the primary product to the aftermarket, may violate competition laws, as it could damage aftermarket functions and lead to foreclosure in the aftermarket.

4. The types of aftermarket cases handled by the FTC include abuse of dominance in the aftermarket (e.g., "maintenance and repair service for elevators" and "auto parts/accessories transactions"), and a vertical merger which combined sales and maintenance services of printers and copiers aimed to lower production costs and complete technology integration.

5. Common conduct whereby enterprises extend the market power of their primary product to aftermarkets includes "tie-ins" and "exclusive dealing." Vertical non-price restraints, e.g., tie-ins and exclusive dealing, fall under the purview of Subparagraph 5 of Article 20 of the Fair Trade Act (hereinafter referred to as the "FTA"), which stipulates that enterprises shall not impose improper restrictions on their trading counterparts' business activities as part of the requirements for trade engagement. According to Paragraph 1 of Article 28 of the Enforcement Rules of the FTA: "Restrictions as used in Subparagraph 5 of Article 20 of the FTA refer to tie-ins, exclusive dealing, restrictions in regard to territory, customers, use, or other aspects of business activities." Paragraph 2 of the same Article states: "In determining whether the restrictions mentioned in the preceding paragraph are improper and being 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." Therefore, the FTA adopts the "rule of reason" for regulating vertical non-price restraints.

6. When reviewing the vertical non-price restraint cases, the FTC first determines whether the enterprise has "market power" in the relevant market. If the enterprise possesses market power, the FTC then evaluates anti-competitive effect in the relevant market. In practice, the FTC may use a 15% market share as a threshold for determining

market power. However, an enterprise with a market share less than 15% may still be deemed to have a dominant position, when its trading counterparts cannot reasonably be expected to deviate from its control. Therefore, the vertical non-price restraints imposed by such an enterprise with superior market power will still be subject to Article 20 of the FTA.

7. Regulations of the FTC related to aftermarkets currently include the "Fair Trade Commission Disposal Directions (Guidelines) on Elevator Enterprise Sales and Maintenance" and "Fair Trade Commission Disposal Directions (Guidelines) on Reviewing Cases Involving Auto Parts (accessories) Transactions." The disposal directions provide a guideline for law enforcement in cases involving elevator enterprise maintenance and automobile parts (accessories) transactions.

2. Market definition in aftermarket cases

8. When defining the relevant market in an aftermarket case, the FTC will determine on a case-by-case basis whether the primary product and the secondary product need to be considered as separate markets, or the markets should be regarded as a system market that includes the primary and secondary products.

9. It is appropriate to view the primary product and secondary product as a system market when: (1) consumers take into account the life-cycle cost (LCC) of a product when making a purchase, i.e., consumers consider both the cost of the primary product and secondary product; (2) brand effects exist and excessive pricing in the aftermarket may severely affect future profit from the enterprise's primary product. Common factors regarding whether or not consumers consider the LCC include: "price proportion of its secondary product to its primary product," "size of purchase of primary product," "availability of information in the aftermarket" and "uncertainty of use of secondary product."

10. When the primary product is infrequently replaced or the cost of consumers switching to other products is very high, consumers may be "locked in" after making a purchase. When the number of consumer lock-in is far higher than that of new consumers in the market, the enterprise's pricing in the aftermarket may be higher than the competitive price. The secondary product may be defined as a separate market in this situation.

11. For example, in the merger case involving Epson printer and projector sales and repair service providers, the FTC defined the "parts and consumables required for repairing Epson printer and projector" (including genuine Epson parts, OEM parts, and usable parts taken out of old printers and projectors) as an independent product market. The FTC found that parts of copiers, printers, or projectors of different brands have low substitutability. Moreover, it is difficult and costly for consumers to obtain the latest information on the prices of parts within the product life cycle, and this raises the concerns of consumers being locked in after making a purchase. Therefore, the after-sales repairs and parts of each brand should be defined as an independent product market.

3. Competition analysis of aftermarket cases

12. Factors considered in competition assessments for aftermarkets usually include the level of competition in primary and secondary markets, the switching cost and the effect of consumer lock-in, the extent to which the primary product and secondary

markets are tied together, the purchasing habits of consumers, and the scope of product patents.

13. Aftermarkets usually relate to the markets of durable goods or continuous services required. As a result of the lock-in effect, enterprises are more likely to abuse their dominant position in such markets. In this regard, the FTC is mainly concerned whether the conduct of an enterprise may curb competition in the aftermarket, and whether the consumers' freedom of choice is restricted.

14. The FTC once investigated whether or not automobile dealers restricting parts sales of distributors was a violation of Subparagraph 5 of Article 20 of the FTA. The FTC found that sales restrictions on automobile parts were all related to theft prevention, the safety of drivers and mechanics, and the requirement for particular equipment, e.g., automobile dealers only sold genuine parts after verifying the vehicle registration, car owner's ID, and serial number on the automobile chassis to prevent theft; such parts are mainly chips or locks configured by the computer. At present, The "Fair Trade Commission Disposal Directions (Guidelines) on Reviewing Cases Involving Auto Parts (accessories) Transactions" requires automobile manufacturers or dealers to disclose important trading information, including a list of parts with sales restrictions, the method used for acquiring the parts, and reasons for the restriction. This is to prevent manufacturers or dealers from damaging consumers' interests by exploiting information asymmetry.

15. Furthermore, factors for determining the lawfulness of tie-ins may include the market power of the enterprise in the primary product, and its "leverage – foreclosure" effect of a tie-in in the aftermarket. This effect will possibly exclude other competitors who have the same or better efficiency from fair competition. Tie-ins, however, may also have positive effects on market competition (e.g., allocative efficiency, maintaining business reputation and quality, and protecting intellectual property rights). Therefore, the FTC should take the justifications held by the enterprise into consideration when reviewing a tie-in case.

16. As for competition analysis in the merger case involving sales and repair service providers for Epson printers and projectors, there were no concerns over market foreclosure because repair service providers were still able to acquire genuine Epson parts, OEM parts, and renewed parts (usable parts taken from old printers and projectors). Distributors of other brand printers and projectors either established their own repair centers (e.g., HP and Fuji Xerox) or worked with other repair service providers (e.g., Canon and Brother). Combined with the large number of repair service providers and lack of entry barriers, there are also no concerns over market foreclosure.

4. Conclusion

17. The main reason for an enterprise to impose restraints in aftermarkets is that the tie-in sales of primary and complementary products may be more efficient (i.e. quality control, complementary product functions, and elimination of double marginalization), and that intersystem competition (software updates and new services) allows the enterprises to directly satisfy consumers' needs and also improve product quality. The advantage of suppliers in the primary product market who also provide secondary products is the ability to provide customers with better services via quality control. Furthermore, when the primary market is highly competitive, it will promote competition

in aftermarkets, and the appropriate protection of intellectual property rights will also benefit product innovation and development.

18. A high switching cost may "lock-in" consumers and prevent them from switching to other products. "Information asymmetry" concerning future costs may prevent consumers from making a better decision when purchasing a product. Manufacturers may be condemned if they abuse their dominant market position in the aftermarkets to damage consumers' interests in this situation. In other words, competition concerns that the competition authority may have are whether manufacturers provide consumers with reasonably priced after-sales service, continue to provide after-sales service, and allow a third party to enter the aftermarket.

19. When the competition authority reviews aftermarket cases, it usually focuses on "how" to assess the impact on competition. Justifiable reasons for enterprises restraining competition in aftermarkets include protection of key technologies or intellectual property rights, guarantee of product quality, or maintenance of their business reputation, or vertical mergers for production cost reduction or technology integration. These IP claims and efficiency claims will help manufacturers provide consumers with better service, and also boost product innovation and development even though this may reduce the number of options consumers have and raise the entry barrier to the aftermarket. In sum, the competition authority needs to contemplate all pros and cons when assessing the competitive effect in aftermarket cases.

20. The main challenge faced by consumers in aftermarkets is to make a choice between a more expensive genuine products and a cheaper OEM product without quality assurance. Considering that primary products and secondary products are complementary, consumers will usually choose genuine secondary products. It is difficult for competition authority to determine whether consumer choice is related to an abuse of market power in the aftermarket, and this often gives rise to debates. Consumers' interests and competition will be enhanced if manufacturers increase their information transparency regarding after-sales prices and encourage third parties to enter the aftermarket.