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Implications of E-commerce for Competition Policy - Note by Chinese Taipei

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More documents related to this discussion can be found at www.oecd.org/daf/competition/e-commerce-implications-for-competition-policy.htm

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This report will introduce regulations on vertical restrictions set forth in the Fair Trade Act of Chinese Taipei and also share the Fair Trade Commission's law enforcement experience associated with vertical restrictions in e-commerce markets.

1. Regulations regarding vertical restrictions in the Fair Trade Act

1. As set forth in Article 19 of the Fair Trade Act (hereinafter referred to as the "FTA"), "An enterprise shall not impose restrictions on resale prices of the goods supplied to its trading counterpart for resale to a third party or to such third party for making further resale. However, those with justifiable reasons are not subject to this limitation. The provision of the preceding paragraph shall apply mutatis mutandis to services provided by an enterprise." The "justifiable reasons" in the article refer to evidence presented by participating enterprises, including encouraging downstream enterprises to improve the efficiency and quality of their pre-sale services, preventing free rides, facilitating the market entry of new businesses or brands, promoting inter-brand competition and other reasonable economic grounds concerning competition, as assessed by the Fair Trade Commission (hereinafter referred to as the "FTC").

2. Meanwhile, it is also specified in Article 20 of the FTA that "No enterprise shall engage in any of the following acts that is likely to restrain competition: …5. Impose improper restrictions on its trading counterparts' business activity as part of the requirements for trade engagement." The "restrictions" in the article refer to tie-in sales, exclusive dealing, and restrictions on the operating region, customers, use, and other aspects of business activities. In determining whether such restrictions are improper and likely to restrain competition, the FTC will consider the intent, purposes and market status of the parties of concern, the structure of the relevant market, the characteristics of the products or services in question, and the impact that imposing such restrictions would have on market competition.

3. Since vertical restrictions imposed by enterprises may simultaneously have pro-competitive and anti-competitive effects on market competition, they are subject to rule of reason analysis. In other words, the imposition of vertical restrictions does not automatically constitute a violation against the FTA. So far, the FTC's law enforcement experience in e-commerce markets has been associated with improper restrictions on business activity imposed on trading counterparts by enterprises as part of the requirement for trade engagement. When handling related cases, the FTC will examine the concrete content of vertical restrictions and determine whether such restrictions are in violation of the FTA by taking into consideration the assessment factors specified in the aforementioned regulations. The same handling approach is applied whether online or offline environments are involved.

2. Cases of vertical restrictions in e-commerce markets

2.1. Online sales restriction clauses

4. Company A, a large domestic bicycle manufacturer, stipulated in its distribution contract that distributors could not directly or indirectly display and sell its products on the Internet without acquiring its written consent in advance. Measures to be taken against breaches of contract were also specified. Company A claimed the main reasons for establishing such provisions were: (i) Customers buying bicycle parts to assemble bicycles on their own could lead to safety concerns and disputes, and the provisions were stipulated to avoid the negative influence of inappropriate online marketing on brand image and product quality; and (ii) The process from assembling to handing over a Company A bicycle to a customer had to be handled by professionally trained salespeople or technicians to prevent customers from getting injured when using the products.

5. After an investigation, the FTC concluded that: (i) Company A's market share in the domestic bicycle market exceeded 20% and it was unlikely that Company A's distributors would switch to selling bicycles of other brands; therefore, Company A had certain market power. (ii) At the time of signing the contracts, Company A disclosed to distributors the content of the online sales restriction clause and also the liability (such as revocation of distributorship, or disconnection of supply) should the contract be breached; hence, the clauses definitely had the effect of deterring distributors from engaging in online marketing even though Company A never actually penalized any distributor. However, Company A never issued any written consent for distributors to sell its products online, either. (iii) Company A permitted its distributors to sell bicycles of other brands and sold its products outright to them. Distributors should have been able to choose their sales channels in accordance with their costs, and supply and demand in the bicycle market. Yet, the clauses restricted the freedom of the distributors to seek transaction opportunities, and the arrangements that the distributors could make to sell bicycles of different brands. At the same time, the clauses suppressed the transparency of transaction information that could promote competition and also reduced the opportunities for customers to choose from a number of transaction channels. (iv) Although Company A asserted that the restriction on online sales was meant to ensure the customer's safety when using the bicycles, there were several kinds of online transaction models, including placing an order online and picking up the product at a physical outlet, and some customers might even have had the professional capacity to assemble bicycles. Company A could not interfere with the liberty of customers to choose from among different transaction channels.

6. Company B, a multi-level marketing enterprise, was another example. The FTC launched an investigation after learning that the company had imposed restrictions on participants intending to sell its products online. Company B contested that, besides ensuring that water purifiers were properly installed and providing buyers with a decent product return or exchange services to maintain brand image, the restriction was imposed after the company took into consideration the characteristics of multi-level marketing, including online sales being inconsistent with the multi-level personnel structure and face-to-face promotion and sales of products. Meanwhile, the investigation showed that Company B did not have market power in the domestic water purifier market. Based on the company's contestation and the coverage of the restriction clause, the FTC found it hard to conclude that the restriction was intended to restrain competition in the water purifier market. The online sales restriction was necessary for the further development of

its multi-level sales organization and could also push participants to understand the importance of product promotion and provide better services to ensure product quality and encourage inter- and intra-brand competition. As specified in the Multi-level Marketing Supervision Act, multi-level marketing enterprises have the obligation to buy back the products when participants rescind or terminate the participation contracts, and this creates a heavier management burden and higher risk for multi-level marketing enterprises, compared to enterprises in other distribution systems. Therefore, the FTC made the decision that the online sales restriction imposed by Company B on its participants did not violate the FTA.

2.2. The most favored customer clause

7. The online purchase agreement template of Company C, a large local online shopping platform, carried a “best price support” clause with the wording, “The supplier guarantees that the product price offered to Company C during the contract period is the best price in the domestic market, and (i) if the price (P1) the supplier offers to a third party is lower than the price (P2, P2 > P1) offered to Company C for the same product, it shall be considered that the supplier offers the same price (P1) to Company C. (ii) When lowering the price of the product (P3), the supplier shall immediately notify Company C and, starting from the time point when the price decrease takes effect, the supplier may not offer the product to Company C at a price (P4, P4≦P3) higher than the reduced price; for products that the supplier has already sent to a location designated by Company C for storage, the reduced price (P4) shall also apply. Company C gave two reasons for establishing the clause: (i) to reduce the cost of price negotiations between Company C and suppliers for the purpose of facilitating the promotion of e-commerce; and (ii) to protect the large amount of money and effort Company C had invested in software and hardware systems and management to promote e-commerce and upgrade service quality, as well as to prevent competitors from taking free rides.

8. Considering the differences between the operating model for online shopping platforms (B2C) and other e-commerce models, and taking into account the sales channel management support available from suppliers and the convenience for shopping customers, the FTC defined the product market as the “online shopping platform market.” Then, after considering the cost of physical product transportation, the importance of delivery time for consumers, transportation fees, language and cultural differences, the cash flow, transaction safety and dispute handling costs, the FTC defined the geographic market as the domestic market.

9. After the investigation, the FTC concluded that: (i) The aforementioned provision appeared to be a most favored customer clause, but it was simply to request that the supplier not put Company C in a disadvantageous position as far as price was concerned. It was not meant to ask the supplier to give Company C better transaction conditions than other competitors. For this reason, the FTC found it hard to consider that Company C had the intent to push up the costs of competitors. (ii) The reasons that Company C claimed were not improper. And it was not feasible that Company C obtained the information about the prices suppliers offered to different online shopping platforms. (iii) The supplier could revise or delete the clause in the agreement while Company C never held any supplier liable, nor did it issue warnings to any supplier for violation of the clause; in other words, the clause was never enforced. (iv) It was specified in Company C’s agreement that suppliers could terminate the agreement at any time. This meant that other online shopping platforms could persuade suppliers to switch to other marketing

channels. In addition, there were many potential cooperation partners in the market for online shopping platforms and suppliers to choose from. There was no evidence that any significant foreclosure had taken place. Hence, even if Company C had a considerable market share in the domestic online shopping market, the FTC concluded that the "best price support" clause in Company C's agreement did not violate the FTA.

2.3. Exclusive dealing clauses

10. Company D, an online store platform operator, signed with online stores service contracts that included the following provisions: (i) As of the time of contract signature, the store operator had not opened online stores to sell products or services on other online store platforms that provided similar services or were competitors of Company D. (ii) The store operator agreed that during the contract period it would only open an online store to sell products or services on the platform of Company D and would not open online stores on other online store platforms that provided similar services or were competitors of Company D. (iii) If the store operator violated the agreement, Company D could shut down the store operator's operations or suspend the entire or part of the service system that the store operator was using, and also terminate the contract. If damages or expenses were incurred by Company D as a result, the store operator would be held liable for compensation. The aforesaid restrictions were typical exclusive dealing clauses. Company D claimed the provisions were established to prevent free rides. The company had invested large amounts of capital, manpower, time and resources over the years to set up and manage the online store platform to provide services, including online sales, online marketing, cash flow and backend management, to allow store operators to sell and display their products or services online. Store operators only needed to pay a fee to open online stores. That lowered the threshold for businesses to enter the e-commerce market. If any online store operator moved to other online store platforms to market its products or services after making enough sales, winning positive ratings, establishing a good reputation and developing the capacity to acquire products as a result of using the platform of Company D, it would benefit other online store platforms even though Company D had shared the operational risk of the store operator. Company D would end up in a disadvantageous position when competing in the e-commerce market.

11. After considering the operating mode of online store platforms (B2B2C), the independence of online store operators and the level of difficulty in brand establishment, the FTC defined the product market as the "online store platform market." Online store platforms made transactions through the Internet, and appear to be borderless. Although virtual products could be delivered through the Internet, most physical products still needed to be delivered to the buyer by traditional logistics channels and shipping costs needed to be considered. Moreover, enterprises preferred to open online stores on domestic online store platforms due to language and cultural differences between countries. Even if foreign online store platforms charged the same or a lower fee than domestic platforms, they did not provide reasonable substitutability as they could not provide a similar channel for serving customers. Therefore, when investigating cases as to whether online store platform enterprises had restricted the business activities of their trading counterparts, the FTC defined the geographic market as the domestic market.

12. As Company D had certain market power in the domestic online store platform market, the FTC considered the following factors: (i) The exclusive dealing clauses imposed by Company D were not an across-the-board restriction on the use of e-commerce models by online store operators. (ii) The exclusive dealing clauses were not a

unilaterally imposed take-it-or-leave-it regulation; online store operators could have the clauses modified or removed after negotiation. (iii) The online store platform market was still rapidly growing and there were no significant barriers or capital thresholds for physical stores to set up online operations. Therefore, besides the enterprises already operating on the platform of Company D, there were still a large number of potential trading counterparts for Company D's competitors to choose from. (iv) Company D allowed store operators to terminate contracts or stop using its service at any time. This meant that even if the store operators were restricted by the exclusive dealing clauses during the contract period, competitors of Company D could still persuade the store operators to change platforms. (v) There was no concrete evidence to show that the exclusive dealing clauses imposed by Company D had increased market entry barriers, created any foreclosure or limited the choice of trading counterparts. Hence, the FTC concluded that Company D had not violated the FTA.

3. Conclusion

13. The regulations regarding price- or non-price vertical restrictions in the FTA have been established in accordance with the rule of reason. As for the former type, the FTC will consider whether there are justifiable reasons. Regarding the latter, the FTC will consider the intent, purpose and market status of the parties of concern, the structure of the relevant market as well as the impact on market competition of the execution of such restrictions to determine whether such restrictions are in violation of the FTA. In principle, the FTC's law enforcement against vertical restrictions will not differ regardless of whether they involve online operations or brick-and-mortar businesses. For example, apart from resale price restrictions, it is only possible for enterprises having certain market power and imposing non-price vertical restrictions to violate the FTA.

14. So far, the law enforcement experience of the FTC in e-commerce markets has been mostly associated with non-price vertical restrictions, including online sales restrictions, and most favored customer and exclusive dealing clauses. Most enterprises have claimed that the purpose in establishing such clauses was to prevent competitors from free riding, and some of them have contested that the restrictions had to be imposed to promote business. In terms of the market definition for cases involving online retail business, the FTC has concluded that online store platforms (B2B2C) and online shopping platforms (B2C) are independent product markets and has also defined the geographic market as the domestic market after taking language and cultural differences, product transportation costs and transaction dispute handling costs, etc. into consideration.

15. At present, there is no monopolistic enterprise in the e-commerce market of Chinese Taipei. Relatively speaking, vertical restrictions are unlikely to lead to restrictive competition or concerted actions. Nonetheless, the FTC will continue to observe whether such restrictions will have an effect on new entrants in the market.