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Monopolisation, Moat Building and Entrenchment Strategies – Note by Chinese Taipei

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1. This paper provides a brief overview of how the Chinese Taipei Fair Trade Commission (hereinafter referred to as the “CTFTC”) perceives monopolisation, moat building and entrenchment strategies in its competition enforcement. It also provides case examples to describe applications of the Fair Trade Act (the “FTA”) in assessing these business strategies.

1. Introduction: definitions of economic moats and entrenchment under competition law

2. In Chinese Taipei, the terms “economic moats” and “entrenchment” are not explicitly defined under the FTA. Neither have these terms been referenced in the CTFTC’s decisions to examine behaviours that may improperly impede or exclude competition. The conceptual elements of the terms, however, have been considered and incorporated in practice when enforcing the FTA. The CTFTC holds the view that there is no need to make a definitional distinction between ‘economic moats’ and ‘entrenchment’ for the purpose of enforcing competition law. Both can broadly refer to strategies and tactics businesses adopt to enable them to protect and preserve their long-term competitive advantage. Generally, such commercial strategies are utilized by businesses in response to market competition, which may lead to positive or negative effects on society and consumers as a whole. In line with an enforcer’s perspective, this paper focuses on negative effects resulting from these business strategies that are likely to improperly restrict competition. The CTFTC assesses whether a moat-building strategical behavior constitutes an anticompetitive practice by erecting barriers to market entry. In the process of assessing whether a business engages in an anticompetitive behavior, the CTFTC will take into account the following factors: the business’s intent, purpose, market position and the structure of the relevant market, as well as characteristics of the goods or services offered by the business and the impact of its behavior on market competition. Such anticompetitive behavior typically aims at harming rivals and may not necessarily seem economically rational in the short term for the business involved.

2. Case examples

3. Economic moats or entrenchment strategies can be implemented not only through monopolisation, but also as a result of mergers, vertical restraints, “most favored nation” clauses and concerted actions. In Chinese Taipei, the existence of most monopolies is derived from sector-specific regulations and/or historical developments in certain industries. Essential facilities and first-mover advantages possessed by the monopolists have served as primary tools to build their economic moats or entrench their market power. In the CTFTC’s past decisions, it found that during the privatization process, some monopoly firms improperly made use of their market power to eliminate or exclude competitors when they faced competition from private businesses. Moreover, the CTFTC also observed that in cases where individual businesses did not possess monopoly power, they were still be able to create entry barriers through cartels or other anticompetitive concerted practices.

2.1. Loyalty programs offered by Tradevan

4. Universal EC Inc. (“Universal”) filed a complaint against loyalty programs offered by Trade-Van Information Services Co. (“Tradevan”) for customs clearance value-added network services. Universal alleged that the ability of customers to switch to an alternative service provider had been inhibited by these programs. Following its investigation, the CTFTC concluded in 2005 that Tradevan engaged in an unfair practice that enabled itself to prevent market entry, thereby constituting a violation of the FTA.

5. Tradevan, a former governmental agency, had been transformed into an incorporated legal entity and assumed operations and assets owned by the agency. In the customs clearance value-added network service sector, Tradevan was an established operator with a ninety-one percent share of the market. Universal was a new entrant with a nine percent market share. As this service market reached maturity and had characteristics of a two-sided market, including network effects, network service users tended to join the network run by the operator with the largest number of users and the greatest variety of user types. Considering Tradevan’s first-mover advantages such as its large customer base and market share, in combination with the above market characteristics, Tradevan had gained considerable competitive advantages over its competitor. As a result, it established a dominant position to enable itself to exercise market power and restrict or eliminate competition.

6. Tradevan introduced two different promotional programs in January 2003. Program A offered a twenty percent discount off the original fee to users who signed up for Tradevan’s network services during the promotional period. Under program B, a forty percent loyalty discount off the original fee would be offered to users who signed up for exclusive use of Tradevan’s network services during the same period. Tradevan also reserved the right to terminate program B and collect the difference between the discounted fee and the original fee if users failed to comply with the agreement.

7. Offering promotions and discounts to compete for transaction opportunities is a common business practice in a free market, normally not subject to scrutiny under competition law. However, from looking at the timeline, Tradevan offered the above promotional programs as Universal was entering the market with a low price strategy to attract Tradevan’s existing users to switch. In response to such competitive pressure, Tradevan’s promotional programs seemed to simply reflect the nature of competitive processes. However, compared to program A, program B was evidently more favorable to Tradevan’s users. Program B imposed conditions that effectively limited Tradevan’s users from switching to the alternative service provider. In doing so, such a loyalty discount resulted in Tradevan’s users being “locked in” and diminish transaction opportunities for Tradevan’s competitor, ultimately leading to an anticompetitive market foreclosure.

8. Based on data provided by Tradevan, over eighty percent of users opted to participate in program B. Should these users like to switch to the customs clearance network service provided by Universal, they would have to pay the differences between the promotional price and the original price as a penalty. The penalty increased the costs of switching between different service providers, and further discouraged users from choosing Universal’s services. The CTFTC found that Tradevan’s introduction of program B was intended to restrict or exclude its competitor, which effectively resulted in more than eighty percent of existing users being unable to switch to the alternative service provider. This had created an artificial barrier to entry into the customs clearance value-added network service market. The CTFTC therefore concluded that Tradevan engaged in anticompetitive behavior.

2.2. CPC's abuse of monopoly power in the domestic aviation fuel market

9. Win Both International Corporation (“Win Both”), an aviation fueling service provider, made two separate requests to CPC Corporation on September 28 and October 19, 1999, seeking quotations to purchase domestic aviation fuel for the purpose of delivering fueling services to Airline A. However, CPC postponed this quotation process multiple times, under the pretext of discussing pricing structures of domestic aviation fuel. By December 1999, CPC had not yet provided the required quotes. This left Win Both with no choice but to enter into a contact with Airline A solely for its international air routes. Meanwhile, due to Airline A's concerns around the potential termination of domestic fuel supply, it decided to extend its existing supply contract with CPC. On January 3, 2000, CPC officially replied to Win Both, refusing to provide quotes and stating that there was no need for the quotes as all of the customers who demanded domestic aviation fuel at Taoyuan Airport had reached supply agreements with CPC.

10. CPC is a state-owned company, regulated by the Ministry of Economic Affairs. In the past, in alignment with national defense and industrial policies, the Government in Chinese Taipei classified petroleum as a strategic material. In the petroleum industry CPC then became a state-owned monopoly and was authorized to be solely responsible for sourcing, storing, transmission, and distribution. While the Government started to open up the market for petroleum imports in 1999, under the then-current aviation fuel supply regulations, CPC remained the only supplier in the domestic aviation fuel market. At the same time CPC also delivered fueling services to domestic airline companies at Taoyuan Airport. The CTFTC observed that Win Both, a fueling service provider for international routes at Taoyuan Airport, was seeking opportunities to expand its business into the domestic service market after Taoyuan Airport started to allow operation of domestic routes. In this context, Win Both requested CPC provision of domestic fuel quotes. CPC delayed its responses to these quote requests and among other things, did not respond to Win Both until it had reached agreements with all the domestic customers for fuel supply at Taoyuan Airport. CPC's refusal to offer quotes constituted an exclusionary practice with the aim of excluding Win Both from competition.

11. Despite that CPC justified its delay resulting from the pending pricing structure in question, the CTFTC found that the costs associated with aviation fuel refining and transportation at Taoyuan Airport were similar for both international and domestic routes. The primary discrepancy between international and domestic services was individual taxes imposed under sector specific regulations, which was clear and readily calculated. The CTFTC found that CPC's argument regarding complexities of petroleum pricing and cost structures was unsubstantiated. Furthermore, in reviewing the contract of domestic fuel supply between CPC and Airline A, the contract did not include an exclusive dealing clause. In practice, it was not uncommon for airlines companies to enter into agreements with multiple fueling service providers to avoid fuel shortages and negotiate more competitive prices. For example, Airline A signed contracts with both CPC and Win Both for its international routes. It was evident that Win Both should have opportunities to compete for customers even when CPC had secured contracts with all customers in the domestic aviation refueling market. The existing contracts between CPC and its customers should not have influenced the CPC's decision to withhold the quote requests from its competitor, Win Both. The intent of CPC's refusal to offer quotes was to prohibit Win Both from entering into the domestic aviation refueling market.

12. In this case, given CPC's monopoly position in the domestic aviation fuel market, its delay in providing quotes was not simply part of the normal course of business, but rather an exclusionary conduct that foreclosed any possibility of Win Both engaging in a

commercial deal with the specific airline company. This, in turn, had an impact on Win Both's future opportunities when competing for customers, and also impeded further market entry of other service providers into the domestic service market. CPC's unjustified refusal to offer quotes to Win Both obstructed the rival company's ability to compete, with the aim of maintaining its market position in the domestic aviation refueling market at Taoyuan Airport. The CTFTC concluded this constituted an abuse of dominance in violation of the FTA.

2.3. Cement cartel among 21 domestic cement businesses

13. In 2005 the CTFTC found that 21 local cement businesses, including 11 cement manufacturers and 10 cement silo holders or distributors, had reached agreements with other competitors by means of joint ventures, contracts, meetings or other forms of mutual understanding. They agreed to restrict each other's business activities by jointly setting prices, coordinating market exits, imposing capacity and resale limits as well as geographic restrictions on imports. The CTFTC concluded that the agreements substantially affected supply and demand in the domestic cement market, which violated provisions of the FTA prohibiting anticompetitive concerted actions.

14. The above domestic cement cartel occurred amidst a sharp decline in cement demand in East Asia following the 1997 Asian financial crisis. This resulted in cement oversupply and global price cuts, which had a significant impact on cement businesses across countries in East Asia. In response to cement dumping by Cemex, the third largest international cement group based in Mexico, in addition to further domestic consolidation, these local cement businesses actively aligned with global competitors to form an international cartel. By doing so, they intended to divide the market and prevent other competitors from entering into the domestic cement market:

1. In this case, despite the supply surplus and lower market prices, the domestic manufacturers reached agreements to establish a joint venture to gain control over distribution channels in certain southern regions. This aimed to facilitate integration of domestic cement manufacturers and prevent Cemex from acquiring distribution channels in these regions.
2. Domestic cement businesses collectively attempted to curb competition by agreeing that certain cement businesses would withdraw from the domestic cement market and terminate their plant operations. They also coordinated to restrict the usage of certain silos, and acquire operating rights to some cement storage facilities owned by the silo holders in order to eliminate or reduce imports of cement and clinker.
3. To avoid price competition, domestic cement businesses entered into agreements with international cement groups including Cemex. They agreed not to sell cement to customers in each other's respective geographic markets and accepted the rotational use of storage facilities located in the regions of the other parties. Through the agreements, the domestic businesses were able to block imports of cement from foreign countries.
4. Moreover, domestic cement businesses and Japanese steel companies engaged in mutually coordinated conduct to reduce exports of slag to Chinese Taipei year after year. As slag was considered a substitute of cement, a decrease in slag imports could result in additional price rises, and consequently minimize its impact on domestic cement sales.

15. The CTFTC's investigation showed that in addition to the price hikes, the substantial impact of the cartel comprising 21 cement businesses included: 1) inefficient or idle operations of certain facilities and silos owned by some of the cement businesses involved, resulting in a significant loss to society; 2) market distortions where the domestic and international anticompetitive concerted practices resulted in higher prices for imported cement paid by domestic customers, and lower export prices of cement sold by domestic cement businesses, which ultimately led to unnecessary transportation costs and economic loss associated with the trade. Additionally, excessive profit margins earned from vertical integration enabled the cement businesses involved in the cartel to cross-subsidize concrete plants operated by their subsidiaries or affiliated enterprises. This impaired and distorted competition in the ready-mixed concrete downstream market and presented difficulties for ready-mixed concrete suppliers, who did not receive any support from upstream cement businesses. In contrast, the scales and profitability of the concrete plants affiliated with cement businesses was less affected. This exacerbated the level of concentration and consolidation in the ready-mixed concrete market.

3. Conclusion

16. During a media interview, a manager of a leading retail company was asked how they actively entered a platform market. The manager stated 'when the existing market has been eroded, and we did not take proactive actions.... This is a matter of survival. We had no choice but to build an economic moat as soon as we could.' ¹This interview indicates that it is not moat building or entrenchment per se that is prohibited under competition law. The retailer adopted certain strategies to facilitate the integration of its visual and physical distribution outlets. Such movement was driven by a competitive threat when a well-known foreign platform operator intended to enter the market. Moreover, consumers may benefit from having more choice of sales channels. Therefore, this report pays particular attention to those "economic moats" or "entrenchment" strategies that improperly create barriers to market entry and exclude existing and potential competition. This position has been held by the CTFTC to inform its enforcement and assessment in previous cases.

17. In the aforementioned cases, Tradevan and CPC were both monopoly firms in the customs clearance value-added network service market and in the domestic aviation fuel market. The market positions and first-mover advantages of both businesses serve as powerful tools for them to establish economic moats. Tradevan was able to prohibit customers from switching to the alternative service provider and thereby effectively foreclosed the possibilities of the rival company to compete for customers. CPC, the only supplier of aviation fuel in the upstream market, and also a downstream operator to provide refueling services, leveraged its market power in the upstream market by refusing to provide quotations that excluded Win Both from competing in the downstream market.

18. In the cartel case involving 21 cement businesses, none of the individual businesses had dominant market power in the domestic cement market. They built an economic moat through cartel agreements. They mutually agreed on market division, rotational use of storage facilities with foreign cement companies, and non-compete arrangements in respective regions. The cartel participants also reached an agreement with Japanese steel companies to limit slag exports, in order to gain the control over the domestic cement

¹ Chen, W.-T. (2024, April 18). "Uncovering the Secret of PXG! Three-year Success in the Fresh Food Delivery Market." *Business Today*, 1426, pp. 82-83.

market and block foreign cement companies from entering the market. This also expedited consolidation in the ready-mixed concrete industry.

19. In conclusion, the terms ‘economic moats’ and ‘entrenchment’ have not been explicitly used in the CTFTC’s cases when describing businesses practices or market positions. However, the concepts have been utilized to inform its decisions. On that note, the CTFTC focuses on the impact of such business practices on market competition by considering whether the practices have created exceptional and unjustified barriers to entry, or whether they have unjustifiably prevented their competitors’ entry, expansion or growth. The intent and purpose of businesses engaging in such anticompetitive practices are also considered. Anticompetitive effects of ‘economic moats’ and ‘entrenchment’ strategies and justifications raised by businesses are taken into account in the CTFTC’s competition assessment, to ensure a better understanding of their overall impact on competition.