

SURVEY ON COMPETITION LAW

IN SMALL ECONOMIES

Special Project for the 2009 ICN Annual Conference

1. Introduction

The 1980's saw a rapid progression in Taiwan's economy that led to the government's decision to shape economic policy and announce a new approach, of internationalization, liberalization and institutionalization. Key elements of this economic reform included the privatization of many state owned firms and the introduction of competition law in 1991. One year after the enactment of the Fair Trade Act (FTA) the Government established the Taiwan Fair Trade Commission (TFTC) as a ministerial level government agency to administer the legislation.

Reviewing the legislative purposes of the FTA, the draft was being proposed to take account of certain attributes of Taiwan's economy. This was recognized and the competition law took account of these factors in the manner in which the TFTC would deal with monopoly traders and mergers.

- 1) Monopolies: To further encourage the development of Taiwan's economy, it seems inappropriate to adopt an entirely negative attitude towards large scale firms and restrict their capacity to develop by taking advantage of economies of scale. Consequently, the TFTC prohibits anti-competitive conduct only when it can be demonstrated that the monopolist has abused its market power.
- 2) Mergers: Similarly, the design of Taiwan's merger control regime included consideration of whether a merger would enhance international competitiveness as well as any potential disadvantages that may arise as a result. The legislation was also designed to ensure that only firms with significant market presence would be subject to merger control and care was taken not to set the threshold for market share too low.

As these two examples demonstrate, the legal provisions of the FTA are intended to provide a balanced approach. While it is important to strike at anti-competitive conduct it is also evident that the legislature had regard to the special attributes of Taiwan's economy in terms of its size and scale.

2. The Notion of a Small Economy

Taiwan is a small open economy, both in a conventional sense and in terms of its economic attributes. On the basis of industry surveys, markets in the respective top 10 manufacturing and service industries tend to show higher market concentrations with the majority of domestic firms operating as small or medium-size enterprises (SMEs)¹. These enterprises are generally international price takers that are confronted by substantial potential foreign competition.

Furthermore, economic development in Taiwan relies mainly on international trade largely because of the scarcity of natural resources and the size of its territory. According to the statistics issued by the Ministry of Economic Affairs², the average yearly degree of dependence on international trade has been approximately 100 since 2002 and its importance continues to increase gradually.

Measured on the basis of overall GDP on PPP basis in 2007³, Taiwan is somewhat comparable to Australia and smaller than South Korea and Indonesia. Consequently, it is more appropriate to define Taiwan as a small economy.

It was not manifest in the FTA as it was first drafted in 1992, whether the legislature specifically took account of Taiwan's relatively small scale economy. However, during the consultation process of drafting new merger guidelines in 2002, the proposals for a pre-notification system for mergers received general consensus without controversy. Both academia and industry raised no objections from this perspective and the proposals were accepted without significant dissent.

3. Anticompetitive Agreement

3.1 Horizontal Agreement

3.1.1 Brief

Horizontal agreements are usually the top enforcement priority for the TFTC and the magnitude of sanctions bears testimony to this. Most fines have been imposed under Article 7 and 14 of the FTA which prohibit businesses from engaging in conduct defined as a "concerted action"⁴. In applying the law to matters related to a "concerted action",

¹ According to the White Paper on Small and Medium Enterprises in 2007 issued by the SMEs Administration under Ministry of Economic Affairs in Taiwan, more than 97% enterprises in Taiwan are SMEs. The SMEs used means in the manufacturing, a paid-in capital of NT\$80 million (US\$2.42 million) or less, and in services or social and personal services industries, sales revenue of NT\$100 million (US\$3.03 million) or less in the last year.

² <http://2k3dmz2.moea.gov.tw/GNWEB/english/indicators/reports/A01.xls>

³ International Monetary Fund: <http://www.imf.org>.

⁴ A concerted action is the statutory basis for the prohibition of cartel conduct. It is defined as conduct through contract, agreement or any other form of mutual understanding to jointly determine the price of goods or services or to limit the

the TFTC adopts a de minimis approach where it is necessary to demonstrate that the prohibited conduct would affect the market mechanism of production, trade in goods, or supply and demand of services. In this context, market share is generally one of the key factors for determining the capacity of such a “concerted action” to affect market function. However, it is not the only consideration and the TFTC has made a decision against a cartel where the market share amounted to only 8.7%.

There are exceptions to the general prohibition against a “concerted action” that can be permitted by the TFTC after prior application⁵. These relate to cases where the TFTC determines that the conduct would be beneficial to the economy as a whole and in the interests of the public. For example the TFTC emphasizes that the businesses demonstrate the joint acts are for the purpose of improving operational efficiency or strengthening the competitiveness of small-medium enterprises. Export cartels and import agreements are two areas where businesses have been able to demonstrate the underlying purpose of the agreements was to reinforce competitiveness in the international market.

The TFTC has prepared two guidelines elaborating on the criteria by which it will authorize specific exceptions that facilitate efficient operations. These are “Principles on Approving Exemptions for Concerted Pricing by Small or Medium-sized Enterprises” and “Principles on Approving Exemptions for oil joint purchase by individual gas stations”.

3.1.2 Price Leading Case – A case study in a small economy

Chinese Petroleum Corp (“CPC”) had been a monopolized provider in the domestic gas and diesel oil market before Formosa Petrochemical Corp. (“FPCC”) entered the market in September 2000. Since then the oil market has been a duopoly, even though ESSO tried to join the domestic market competition in 2002.⁶ According to the sales volume of gasoline and diesel oil, FPCC and CPC have a market share of 30% and 70% respectively.

The TFTC launched an investigation against the only two gasoline suppliers in 2003 for the purpose of examining their pattern of simultaneously adjusting their wholesale prices of 92 and 95 unleaded gas and premium diesel oil. Based on the TFTC’s investigation, it was found that CPC and FPCC simultaneously adjusted the wholesale

terms of quantity, technology, products, facilities, trading counterparts or trading and thereby restrict each other’s business activities. (Article 7)

⁵ Seven categories of exemption include uniform specifications (to reduce costs, improve quality or increase efficiency), joint research and development, specialization and rationalization of operations, export cartels, import agreements, crisis cartels and agreements among SMEs to improve efficiency and strengthen competitiveness. (Article 14)

⁶ Esso tried to enter, but exited after less than two years as a result of fewer distributors, higher tariffs and statutory storage requirements. In the short term, the domestic market in Taiwan may not have enough capacity for another new competitor and timely entry into this market is unlikely.

price within the same range at least 20 times. The scenario on the adjustment in the price by the two companies was:

- 1) The initiating party would issue an announcement in the media with respect to a decision to change its price.
- 2) If the respondent decided to follow, the two wholesale prices of the two competitors would be adjusted within the same range at the same time.
- 3) If the respondent decided not to follow, then the initiating party would immediately withdraw or make an amendment to its earlier decision.

The TFTC held that the use of the media to announce price rises was in effect a public negotiation of price adjustments both parties. This affected the capacity of most gas station operators to compete in terms of price and eventually had an adverse influence on consumer welfare. In the circumstances, the TFTC was of the view that this resulted in detriment of the wholesale and retail markets for petroleum- related products.

In the first instance, the TFTC sent a letter to the two firms in question warning them not to use advance announcements to jointly change wholesale prices. Because they disregarded the warning and continued concerted action in violation of Article 14(1), the TFTC in October 2004 imposed an administrative fine of TWD 6.5 million on each firm. The appeal and petition committee of the Executive Yuan revoked the TFTC's decision to impose a fine. In July 2005, the TFTC imposed the identical fines again and the decision is still on appeal.

3.1.3 Summary

Based on the experience of the TFTC to date, some enforcing characteristics can be summarized as follows:

- 1) Efficiency has been one of the legislative goals being pursued in a small economy. The TFTC relaxes regulation which allows for some horizontal agreements but only in circumstances where it can be demonstrated that there exists a net public benefit, usually through efficiency gains. Notwithstanding the international trade may be the alternative of allocating more efficiently the domestic products and services, foreign firms possibly can't compete with domestic firms under the limited size of economy.
- 2) The TFTC's focus has been on markets where there exists a higher concentration of market power largely because collusion in these markets results in more widespread detriment. The TFTC takes more actions and imposes stricter sanctions that

specifically target hard-core cartels that substantially impede competition without any contribution to economic efficiency.

- 3) In the last year the TFTC resolved 7 actions that contravened the provisions of the FTA concerning cartels. Business associations, such as the jewelry commercial association, non-life insurance association, tourist bus association and liquefied petroleum gas association, accounted for more than half of the cartel cases. In these relatively conservative industries, often operating at a more regional level, joint pricing is much more common. There is also a tendency towards anti-competitive practices which seems to stem from the leadership of these associations that have a well entrenched business culture.

3.2 Vertical agreements

Vertical agreements can be divided into two types in Taiwan:

- vertical price restraint such as retail price maintenance; and
- non-price restraint which refers to agreements where the terms are restrained or restrictive conditions are imposed between firms at different levels of the production and distribution process.

The TFTC takes different approaches to coping with these issues under the FTA. The opposition to resale price maintenance is that it impedes inter-brand competition. Consequently, the setting of maximum or minimum levels is prohibited and is a *per se* offence pursuant to the Article 18. However, the ban applies only to setting resale prices of goods, not of services. Until now, very few cases have been received by the TFTC. However, in the early stages of enforcement of the FTA the TFTC took action in a number of matters related to imports that sought to impose vertical restraints, especially in respect of cosmetic companies.

Non-price vertical restraints, which receive rule-of-reason treatment, are catalogued separately under the Article 19. The practices listed there are prohibited only in circumstances where it can be demonstrated that they lessen competition or impede fair competition. For example, inducing a refusal to deal is dependent upon demonstrating that the underlying “purpose” was to injure the firm that is prevented from access to goods or services. Discrimination is similarly prohibited where it is “without justification and other conduct is forbidden when done “improperly” or through “improper means”. There are general guidelines that clarify further the concept of “the likelihood of impeding fair competition” under Article 19 as well as other more specific guidelines for certain industries,

such as the distribution industry.

In 1992 the TFTC issued explanation No.3 in respect of parallel imports⁷. It points out firstly that a parallel import won't be regarded as a counterfeit for the purposes of Article 20 of FTA unless, by virtue of Article 21, it can be demonstrated that the importer intended to mislead consumers as to the source of the products. In addition, where an authorized agent has established their market presence and made considerable investment in making the authorized products well known to consumers, other unauthorized companies can not mislead consumers into believing the products were imported by the authorized importer. Such "free-riding" is obviously deceptive or unfair conduct and will be an infringement under Article 24.

In sum, apart from resale price maintenance, vertical agreements and parallel imports are not illegal in Taiwan, particularly non-price vertical restraints which are closely linked with resource integration and enhancement of efficiency. In terms of sanction, the TFTC has issued only a few decisions about vertical restraints.

4. Abuse of Dominance

Taiwan's economy is predominantly made up of SMEs⁸ but their sales only amount to 29.84% of total sales created by all enterprises. A mere 3% of enterprises account for more than 70% of total sales in Taiwan which underpins their importance to the economy.

Taiwan's economy also has 6 state owned companies⁹ including the Taiwan Power Company, CPC Corporation, Taiwan Sugar Corporation, Taiwan Water Supply Corporation, CSBC Corporation and Taiwan Aerospace Industrial Development Corporation. To date, the electric power distribution, oil and tap water markets have been monopolized by the state owned companies.

As noted above, since the inception of the FTA, the legislators sought to ensure that a monopolist could not abuse its dominant position. This also extends to large firms who enjoy a dominant position such that they are in a position to exclude competition from a relevant market. There is no positive presumption in respect of what constitutes a monopoly but it is a prerequisite to establishing liability that a business falls inside the definitions relating to market share criteria in Article 5-1.

⁷ For the purposes of the Trademark Act, a parallel import is not regarded as a criminal infringement either. (Refer to Taiwan High Court judgment No 30 in 2008, only available for Chinese Version)

⁸ See the footnote 2

⁹ <http://www.sec.gov.tw/English/CNCAFRAME2.HTML>

Article 10 prescribes the types of abuse that monopolistic enterprises may not engage in and these include:

- preventing others from competing by unfair means;
- setting, maintaining or changing prices improperly;
- demanding preferential treatment without justification; and
- otherwise abusing their market power.

There are no provisions for exemption or defense against the abuse of dominant position. However, some balancing of restrictive effects against ordinary commercial considerations is implied by means of explaining the allegedly abusive conduct as “improper,” “without justification” or “unfair”.

As for collective dominance, two or more enterprises may be viewed as monopolistic enterprises if they do not in fact engage in price competition with each other and they have the same overall status as single firm dominance under the paragraph 2 of Article 5. In a way, FTA appears to permit this finding to be based simply on the fact that firms are not competing, that is, in situations of oligopoly co-ordination and interdependence. However, in practice, decisions applying Article 10 have generally only involved situations of single-firm dominance.

5. Merger

The TFTC had implemented the pre-merger application system since the FTA came into force in February 1992. A merger application must be made to the TFTC for prior written approval where the parties involved have a certain sales volume or market share. By the end of 2001 the TFTC had received a total of 5,811 cases for merger approval. With the TFTC making very few decisions against mergers, the original system caused a burden on business reporting as well as a drain on administrative resources.

In response to the shift in industrial structure and streamlining administrative procedure under the consensus among economic consultative conferences, the amendments in 2002 changed merger control to a pre-notification regime. This regime eliminated the need to await formal TFTC approval and shortened the review period from 2 months to 30 days. In sum, the parties can proceed to merger if the TFTC takes no action within 30 days after notification¹⁰. Furthermore, revising and raising the turnover threshold used to determine whether a merger application is required decreased the number of notifications sharply from hundreds (even thousands) of cases per year to dozens of cases per year. This shifted focus to those mergers that

¹⁰ Where any enterprise(s) fails to file a notification for any merger, the TFTC has authority to prohibit such merger, prescribe a period for such enterprise(s) to split, to dispose of all or a part of the shares, to transfer a part of the operations, or to remove certain persons from positions or make any other necessary treatment.(Article 13)

are more likely to result in substantive anti-competitive effect, rather than more marginal merger cases.

So far, the TFTC has received a total of 6,375 merger cases. However, there have only been seven merger applications that have been refused. Four of these were in relation to the Cable TV industry where high market concentration and entry barriers exist. One merger application refusal was in relation to the vertical merger between a monopoly petroleum supplier and gas stations prior to the existence of free importation of oil products in Taiwan. In the last two years, the TFTC prohibited two mergers - one involved two major companies providing audiovisual & singing services, namely, karaoke with video lyrics display capabilities; and the other involved two instant noodle companies. Among these cases, the reasons for objection are in general divided into matters where:

- 1) a monopolized position in the relevant market already precluded timely efficient entry to that market; or
- 2) the result in the post-merger market may create barriers to entry to that market.

Put briefly, because of Taiwan's small and open economy the TFTC issued general merger guidelines in 2006 to relax the restrictions on those mergers which may not significantly lessen competition. Underpinning the TFTC's decision to adopt this stance were the following considerations drawn from past experience:

- 1) Provided that the mergers fall within any type reviewed by simplified procedure, in principle, it will be presumed that the overall economic benefits of the merger outweigh the disadvantages resulting from competition restraint. As for the other merger cases, in accordance with general procedures, the TFTC will make a further review only if the merger is likely to result in a significant lessening of competition.
- 2) If the merger will not raise any substantial anti-competitive concern, it will be presumed that the overall economic benefits of the merger outweigh the disadvantages resulting from competition restraint.
- 3) In respect of horizontal mergers and the requirement to restrict consideration to only those matters that meet certain market share requirements¹¹, the TFTC would require evidence that

¹¹ The criteria of market share are respectively: 1) The combined market share of the merging enterprises reaches 50 percent. 2) The market share of the two largest enterprises of the relevant market reaches two-thirds. 3) The market share of the three largest enterprises of the relevant market reaches 3/4. For circumstances stated in the above-mentioned second or third paragraph, the merger in which the combined market shares of enterprises participating in the merger have to reach to 15%.

the resulting merger would result in a substantial lessening of competition, in which case the overall economic benefits shall be reviewed further.

Consequently, the TFTC is accelerating the merger review procedure step by step and loosening the restriction on mergers that are unlikely to result in any substantial anticompetitive effect. In relation to the introduction of thresholds for merger notification, the TFTC is deliberating upon whether to eliminate market share as a criterion as this may limit geographic markets to domestic markets without due regard to Taiwan's economic circumstances.