

# **A Study on Cases related to Fair Trade Law Involving the Domestic Dairy Product Market**

## **1. Study Background**

Located in the subtropics, Chinese Taipei originally was not an ideal place for raising dairy cattle. However, in order to safeguard the health of the people as well as assure self sufficiency in supply of milk and development of related businesses, the government has spared no effort to support the dairy industry over the years. Dairy products spoil quickly. To help dairy farms to develop, the agricultural authority and related industrial and health agencies established the “Dairy Industry Administration Regulations” in 1973 to serve as the guideline for dairy farms and dairy factories to produce and market their products. Meanwhile, to maintain milk production and sales, the Council of Agriculture began to promote the “Diary Industry Satellite Ranch System” in 1987 for dairy product manufacturers and dairy farmers to sign raw milk supply and sales contracts to form “satellite ranch” relations to assure transaction channels could stay smoothly open. On top of that, the government also helped with and protected the development of domestic dairy industry and stipulated that all raw milk supply had to come from domestic sources. As a consequence, fresh milk producers and dairy farmers became highly interdependent and inseparable. Systematic production and sales were planned in accordance with consumer demand in the market. Later, as Chinese Taipei was about to join the World Trade Organization, the Council of Agriculture stopped allocation of dairy sources and dairy zones in 1992 and also abolished the restriction that each dairy farmer could only sign contracts with one dairy factory, so that the market mechanism could be restored.

In the early days, raw milk purchasing prices of different regions and dairy factories were not unified and disputes occurred often. To stabilize cooperation between dairy factories and farmers, the Department of Agriculture and Forestry approved in 1976 the “Regulations Governing Dairy Factory Acceptance Inspections of Purchased Raw Milk and Price Calculation” to set the basis for determination of milk prices. Due to production cost and commodity price fluctuations later, the milk price system and prices were adjusted several times after consultations, including the trial implementation of the single milk price regulation in 1975 and the summer, April to November, and winter, December to March the following year, prices adopted between 1976 and 1989. In 1990, three prices were adopted for different periods, including winter (December to March the following year), Summer (June to September, and the warm periods (April, May, October and November). The decision was made to encourage dairy farmers to make production adjustments systematically.

Current raw milk purchasing prices are decided in accordance with Paragraph 1 of Article 35 of the Animal Industry Act, “The National Animal Industry Foundation may organize a raw milk price appraisal committee and submit raw milk reference prices to the central authority in-charge to make an official notice.” The “Raw Milk Acceptance Inspection and Price Calculation Guidelines” has been established pursuant to this regulation and a price evaluation committee composed of dairy farm representatives, dairy factory representatives, scholars and experts, and representatives from the National Animal Industry Foundation to set referential raw milk purchasing prices according to objective cost data. However, whenever raw milk prices fluctuate, fresh milk prices also go up and down.

The FTC has consulted with the Council of Agriculture on a number of occasions. Due to the fresh milk production and sales imbalance between summer and winter, larger production but smaller market demand in winter and smaller production and higher demand in summer, the Council of Agriculture is convinced of the necessity to set raw milk purchasing prices. The FTC respects the decision of the competent authority. However, seasonal raw milk purchasing price rises have often happened since 1999. In consequence, fresh milk suppliers have made price adjustments simultaneously. In the 406<sup>th</sup> Commissioners' Meeting on Aug. 18, 1999 and the 438<sup>th</sup> Commissioners' Meeting on Mar. 29, 2000, the FTC decided to invite dairy businesses and the competent authority of the industry to inform them of the FTC's law enforcement standpoint before the milk price change took place at the end of March each year. Nonetheless, the three major fresh milk suppliers still raised the prices at the same time in early October 2011. After an investigation, the FTC concluded the three major dairy product suppliers had engaged in a concerted action and gave out sanctions and the decision was supported by the Supreme Administrative Court later on. The decision was made in spite of the lack of direct evidence of the suppliers achieving a mutual understanding on the price increase. The FTC adopted circumstantial evidence, inferred with additional factors taken into account and concluded that the simultaneous price increase would have been impossible without establishment of a mutual understanding beforehand. This is also why the reason behind the decision of the Supreme Administrative Court truly has its referential value.

Since 2011, the import costs of infant formulas in Chinese Taipei have continued to increase and infant formula suppliers have jacked up their prices to reflect such rises. The Legislative Yuan and media have expressed their concern. The FTC has kept a close eye on the developments and also attended several meetings convened by the working groups of the "Commodity Price Stabilization Task Force of the Executive Yuan" and the competent authority to offer suggestions as a competition law enforcer. In fact, no businesses have set up plants to produce infant formulas in Chinese Taipei. All such products are imported in the original packaging. Some domestic businesses have signed OEM contracts with dairy factories overseas to market infant formulas of their own brands, but the market shares they account for are way behind those of major international companies. Furthermore, infant formulas are special nutrients that have to be inspected by and registered with the Ministry of Health and Welfare before they can be marketed. Plus, advertising and promotional activities for formulas for infants less than one year old are prohibited. As a result, market prices are not transparent. What's more, because of domestic consumers' brand dependence and the market structure, price competition on infant formulas is not obvious. Instead, businesses compete by building up their brand image (such as organizing Mom classroom activities to promote products) and adopting other non-price competition approaches. Therefore, it is necessary to further clarify the marketing patterns of infant formula businesses and bring the infant formula industry under regulation.

As infant formula and fresh milk businesses both belong to highly regulated industries, the concern expressed from different sectors toward price changes in related product markets is higher than the concern toward any other daily commodities. The FTC has established a certain number of sanction precedents and accumulated enough administrative court decisions from processing cases associated with fresh milk and infant formula businesses. To facilitate assessment of future cases by resorting to past experience, it is necessary to review indicative cases in which sanctions were

administered in the past and organize systematically the reasons behind administrative court decisions to seek inspirations and come up with related suggestions for reference in future law enforcement.

## **2. Study Methods**

Actual cases are reviewed for this study to accumulate experience, including visits paid to dairy farmers in Chiayi, Changhua, Kaohsiung and Pingtung, pharmacies selling infant formulas, etc. Statistical data from organizations, governments and academic institutions in and outside the country are also collected and examined to understand the competition patterns in the domestic dairy market. The full text search system of the FTC and dispositions issued, and the legal data search system of the Judicial Yuan are also adopted to examine the FTC's investigations and sanctions over the years and the reasons behind administrative court decisions. Reference is also made to related academic papers to study the history of the system of administration of fresh milk and infant formula businesses. Decisions made by competition authorities in related cases and court verdicts in other countries are also reviewed.

## **3. Conclusion and Suggestions**

The event of infant formula price increase this year is not yet over. The Commissioners' Meeting has concluded on a regulation application viewpoint different from the ones made in the past. Therefore, this study particularly focuses on infant formulas, besides out of the intention to construct the history and context of the overall development of the industry, in order to sort out related cases around the world. The conclusion of this study is that the development of the infant formula industry is closely associated with the regulatory measures adopted by the competent authority. For this reason, during law enforcement operation, the FTC ought to take into account the policy of the competent authority in order to assess whether there is actual connection between the means and objectives of regulation and also to assure market competition and the welfare of consumers will not be jeopardized.

An inspection of the history of infant formulas indicates they were first invented by pharmaceuticals. Therefore, in the early days, infant formulas were marketed just like medicines through medical detailing. Sales representatives from pharmaceuticals visited medical institutions to brief physicians on the products and offer various special offers, so that physicians would recommend the products. Later, infant formula salespeople even visited medical institutions to make direct contact with parents and hold different activities to build up brand identification among parents. Certainly, all the expenses incurred were transferred to consumers directly.

In the US, infant formula businesses spend huge amounts of money on marketing each year to offer hospitals free products and even obtain the exclusivity to sell their products in different hospitals through royalty bidding. Investigation reports from the Competition Commission of Singapore indicate that local infant formula businesses keep increasing their marketing expenses to establish good brand image in consumers. To some extent, such non-price competition pushes the prices of infant formula to go up, but it is the result of interaction between suppliers and consumers.

Most infant formula suppliers in Chinese Taipei are foreign companies. They also adopt the aforementioned marketing pattern to win the confidence of consumers

through brand marketing. Consumers are partial to good brands and this makes infant formula businesses value their brand image even more and invest increasing resources to market their products. Nielsen's 2015 global survey data revealed that "reassuring ingredients and production processes" were the most important consideration for 45% of the total domestic interviewees, 9% higher than the global average of 36% and ranking No. 5 in the world. Only 11% expressed that "cost effectiveness" was an important consideration for them, 14% less than the global average of 25%. This proves that there is indeed room for development for domestic high-end products and this has an effect on the marketing and pricing strategies of infant formula businesses. Judged by the market structure, the three major infant formula suppliers in Chinese Taipei are foreign companies (Nestle, Abbott and Snow Brand, in descending order according to their market share). The headquarters of these companies decide the final price adjustment strategy. As for the local company Orient EuroPharma (No. 4 in market share), its products are produced by dairy factories overseas and sold under its own brands. The pricing patterns of these businesses are all different. Judged from the angle of international competition law enforcement, infant formula price increases in the past have not always been the result of concerted actions. In fact, sometimes when the competent authority started to intervene before infant formula prices went up, infant formula suppliers were indirectly pushed to unite, such as the Puerto Rican government inviting infant formula suppliers to meet and discuss a bid for procurement of infant formulas and disclosing its preferences, and the Italian Competition Authority and health authority requesting infant formula businesses to lower prices and infant formula suppliers getting together to discuss the margin of decrease. The FTC ought to take these as lessons during law enforcement operation.

Prohibition of advertising and promotional activities for infant formulas has its historical background. When the FTC was first created, infant formulas could be sold without restrictions in hospitals and the situation became chaotic. Consumers' brand myth and the erroneous perception that formulas could totally replace breast milk once caused the domestic breast-feeding rate to drop down to 5%. To ensure babies could get enough nutrition and stay healthy, the health authority acted according to the International Code of Marketing of Breast Milk Substitutes from the World Health Organization and promoted a series of measures. Among them, the most important was prohibition of advertising for infant formulas and inappropriate promotions in hospitals. The measures were indeed intended to promote breast feeding to protect the growth of infants. For this reason, the FTC, after assessing the historical context and background, respects the decision of the competent authority.

However, with certain aspects taken into consideration, prohibition of promotions and advertising may have indirectly reduced the transparency of market information. Therefore, when attending in 2017 the meeting convened by the "Infant formula Price Special Task Force" of the National Development Council, the meeting on "Review of Price Changes in the Infant Formula Market and Establishment of Countermeasures" held by the Consumer Protection Committee and the "Presentation on the Administrative Measures for the Infant Formula Market" conducted by the Ministry of Health and Welfare, the FTC fully communicated with related competent authorities and successfully persuaded them to reach the resolution of making infant formula information more transparent by publicly announcing retail prices and integrating such information with product registration data and product inspection results. Today, infant formula retail prices and related information are available on the Commodity Price Information Bulletin Board of the National Development Council,

including the average retail price, price per 100g, ingredients, importers and countries of origin. It is hoped that infant formula market information can become more transparent to facilitate consumers to compare brands and prices and make their choice accordingly. The same problem has also happened in other countries and regions. When the infant formula market went wrong in Hong Kong, disclosure of the prices at different retail outlets successfully increased market transparency. When sanctioning infant formula suppliers, the Italian Competition Authority also mentioned adoption of suggested prices could make it easier for businesses to collude with one another. Therefore, disclosure of price ranges on electronic invoices without disclosing store names allows the FTC to keep track of price adjustments made by infant formula suppliers. This has to be a better approach.

As for the question of regulating importation of infant formulas, it is because according to the “Act Governing Food Safety and Sanitation” and the “Special Nutritional Food Inspection and Registration Regulations”, infant formulas for infants less than one year old have to be inspected and registered before they can be marketed. After they are approved to be marketed, businesses have to send their products to be inspected by the Food Industry Research and Development Institute on a quarterly basis. Health units also carry out random inspections each year. The complicated global industrial chain seems to have the butterfly effect. Any tiny mistake will rapidly affect every corner in the world. Above all, infant formulas are consumed by the most vulnerable and most sensitive consumers. An error or any negligence can lead to a critical safety incident. Hence, the inspection and registration system does have its necessity. Even if the inspections and registration can cause cost increase to businesses, including inspection expenses and fees, it is unlikely to create any entry barrier to parallel importers. Currently, parallel importers do not exist in the market mainly because of consumers’ product quality and brand preferences. Plus, domestic infant formulas are cheaper than in neighboring countries. There is not much room for parallel importers to make a profit. Hence, according to the outcome of this study, the inspection and registration system at this point can facilitate tracing of food sources. For example, when the infant formulas from Lactalis, the second biggest dairy product maker in the world, were contaminated by salmonella not long ago and three domestic infant formula importers were affected, the competent authority was able to demand related businesses to remove their products from the market at the earliest time because it already had the list of importers. To expedite food safety control and disposition at the earliest time, such administrative control measures do have their necessity. Other countries also have their infant formula inspection regulations. In Singapore, the Competition Commission is convinced parallel importation should be enhanced. However, relaxing the inspection and control measures may weaken food safety control. Therefore, prudence is required.

A close examination of related cases in other countries reveals that most countries also have faced the problem of infant formula price increase although the causes differ, including growing demand, market shortages, preferences for good products, market distortions caused by funding policy or a combination of some of such factors. In Egypt, increase of childbirths has led to growing demand for infant formulas. In Saudi Arabia, the same thing has happened, plus the increase of women’s labor force participation rate. In Hong Kong, it was the result of parallel importation to China and panic among the locals. In China, consumers’ demand for imported infant formulas escalated after the melamine incident. In the US, the government created a market distortion by giving subsidies for infant formula purchases. The countermeasures

taken in different countries also varied. Saudi Arabia issued an administrative order to impose direct price control. Hong Kong applied criminal measures to ban parallel importation. Egypt extended its subsidy measure and put importation of infant formulas out to tender to increase sources and reduce purchasing prices. The US adopted a funding system and a bidding system for the government to procure infant formulas. Nevertheless, all such measures were proposed by the competent authority of the industry. The competition authority found it inappropriate to intervene.

At present, competition authorities usually offer suggestions related to competition in the infant formula market, especially price competition, to the competent authority of the industry. In Greece, the government abolished the restriction that infant formulas for six-month-olds could only be sold in pharmacies. The Competition Commission of Singapore came up with the three suggestions for the competent authority, namely enhancing consumers' knowledge about infant formulas, reviewing the practice of infant formula suppliers providing hospitals with free infant formulas, and reviewing the feasibility of parallel importation. The Competition Commission in Hong Kong suggested the health authority to revoke the self-discipline agreement on prohibition of promotional activities. Only the Italian Competition Authority exceptionally intervened in an infant formula business merger because the competent authority had launched an investigation into the suspected concerted action of the merging parties. As a consequence, the businesses took the initiative to lower prices to acquire the approval of the competent authority for the merger. The case appeared to have exceeded the jurisdiction of the competition authority. The Italian Competition Authority did not deny the decision had been made because of the particular circumstances at the time and it had to be the first time and the last time. If women had the choice between breast feeding and using infant formulas; price decreases could result in more women choosing the latter and the outcome could have a negative effect on the health of newborns.

In conclusion, whether it is infant formula price control or raw milk purchasing price control, the competent authority of the industry has to consider the likely impact of its regulatory measures and system design on the market. As for the various countermeasures adopted by the competent authority, the FTC respects the decision of the competent authority and will continue to communicate with the competent authority and also offer suggestions if any measure is deemed likely to restrain market competition. In addition, the FTC should make sure not to intervene in the market excessively during investigations and law enforcement operation and also adjust its competition policy and industrial policy to work with the competent authority to enhance price transparency in the market and the awareness of businesses and consumers. For example, the health authority has tried hard to break the myth about infant formula brands, reinforce promotion of breast feeding and enhance consumers' ability to identify domestically produced fresh milk and other liquid milk. The FTC will continue to communicate with related businesses on advocacy of competition to make them understand related competition regulations and the law enforcement standpoint of the FTC to build a free and fair competition environment in the dairy product market.